INDEX

FACILITY ASSOCIATION ARGUMENT

INTRODUCTION

The purpose of the present hearing is to consider an application filed by Facility Association for approval of rates which it proposes to charge for automobile insurance placed through the mechanism of the Association.

The present application is governed by the *Public Utilities Act*, the *Insurance Companies' Act*, the *Automobile Insurance Act*, and the *Automobile Insurance Rating Bureau Regulations*, (Newfoundland Regulations 737/96).

Pursuant to the statutory process, Facility Association, with the expert assistance of Eckler Partners Ltd. ("Eckler") has filed for overall rate increases of +41.3% for Private Passenger and +48.3% Commercial vehicles. Facility Association also proposes the implementation of the Canadian Loss Experience Automobile Rating System ("CLEAR"), and the introduction of an integrated 10% clean driver discount for those free of accident and convictions and changes to the accident/conviction surcharge schedule.

The increases proposed are significant, but as Mr. Anthony and others have testified, rates in the general market have increased between 30% and 40%, and consequently, it is not surprising that Facility Association rates would also be increasing in line with what is occurring for the very best drivers. As has been Facility Association's past practice in Newfoundland and in the other jurisdictions in which it operates, the filing anticipates sufficient surplus to pay only the direct expense of Facility Association member companies which include premium taxes and health levies.

There has been considerable discussion over the concept of rate cross-subsidisation by persons insured in the regular market when Facility Association premiums are inadequate. That reality was addressed by Mr. Pelly, Mr. Hickey, Ms. Power and Mr. Anthony. That concern was also addressed in a number of commentary letters received by the Board from individuals who, for one reason or another, were unable to attend the actual hearing to address the Board directly.

It is generally recognized that Facility Association itself must, of necessity, realize a surplus from its operations to permit member companies to recover their direct out-of-pocket expenses. An additional expense not recognized in the rate filing and not calculated directly in the financial statements of the member companies includes each individual member company's cost of

capital. The Board's own actuary confirmed that Facility Association results are shared amongst all of the companies writing automobile insurance in the Province, and as a result, member companies are required to allocate capital to cover their share of the Facility Association business, as if it were their own direct business. She also confirmed that as a result of Facility Association rates being set on a breakeven basis, whatever rate of return member companies hope to achieve must, of necessity, be achieved solely within the regular market. As a result, there is a persistent component of rate subsidization by the regular market based on the Facility Association rate setting philosophy.

It may be helpful to set out the history to the present Facility Association in this jurisdiction. The first statutory reference in Newfoundland to an industry mechanism for providing high risk drivers with automobile insurance appeared in 1961 in the *Insurance Companies Act*, section 83(1):

> "Every insurer licensed to issue motor vehicle liability policies shall subscribe to the Newfoundland Automobile Assigned Risk Plan and be a member of Judgment Recover (NFLD.) Ltd., and is bound by any and all provisions governing such subscribers and members."

At that time, there was no regulation in Newfoundland of automobile insurance rates and automobile insurance was not compulsory. Minor amendments to the relevant provisions of the *Insurance Companies Act* were made in 1968 with section 83 amended as follows:

> "Every insurer licensed to issue motor vehicle liability policies shall subscribe to the Newfoundland Automobile Assigned Risk Plan or any other plan in lieu thereof, approved for the purpose, at any time and from time to time, by order of the Lieutenant Governor in Council, and be a member of Judgment Recovery (NFLD.) Ltd. and is bound by any and all provisions governing such subscribers and members."

Insurance rates were first regulated in Newfoundland in 1975 with the passing of the *Automobile Insurance (Amendment) Act*. Under the scheme created at that time, the Newfoundland Insurance Board was established to approve rates charged to the general public. Policies for all risks were issued by individual insurance companies. If insurers were not inclined to carry

any particular risk individually, that policy was ceded to the Assigned Risk Plan, or its successor plans, and the risk was then shared collectively among all automobile insurers, as is the case today with Facility Association. Coincidental with the introduction of regulated automobile insurance rates in 1975, amendments to the *Highway Traffic Act* in June, 1975, made automobile insurance compulsory for all motor vehicles operating in Newfoundland. For approximately the next 10 years, while automobile insurance in Newfoundland was compulsory, no special rates were prescribed particularly for the Assigned Risk Plan, rather individual insurers issued policies to high risk drivers using their own profit motivated rates, and then if a risk was not within that insurer's underwriting guidelines, it ceded the policy to the industry operated Assigned Risk Plan. During this period there was no statutory requirement that the Assigned Risk Plan mechanism be operated on a "not for profit" basis.

In 1977, the Newfoundland Automobile Insurance Board was replaced by the Public Utilities Board, and the new legislative scheme, which remains in place today, prescribed that rates charged by an automobile insurer, operating in Newfoundland, required prior approval of the Public Utilities Board.

In 1985, 10 years after the introduction of regulated rates and compulsory automobile insurance, further amendments to the *Insurance Companies Act* first introduced the present "Facility Association" in Newfoundland. Section 83 was amended to read:

> "The Newfoundland Automobile Assigned Risk Plan, established as an unincorporated association under section 83 of the Act, before the commencement of this section *is continued* as an unincorporated, non-profit association of insurers known as the Facility Association under this section" (emphasis added).

The 1985 legislation (the "1985 Act") made membership in Facility Association compulsory for every insurer licensed to transact automobile insurance in the Province, just as previously they were obligated to be members of the industry operated Assigned Risk Plan.

It should be observed that there is no legislation in force in this Province which compels any insurer to individually make automobile insurance

available to any particular automobile owner or licenced automobile operator. Automobile insurers are unrestricted in establishing their individual underwriting practices and criteria. That ability to develop and utilize an individual or unique set of underwriting guidelines is the very essence of their business. Persons who are unable to obtain automobile insurance in what is often referred to as the "voluntary market" must, by legislation, have insurance made available by all insurers operating within the Province through the mechanism of Facility Association.

Implicit in this legislative scheme is the right of Facility Association and the right of its members to have automobile insurance rates approved for Facility Association which reflect the entire costs to those member companies of providing insurance through that mechanism.

It is the responsibility of the Board, therefore, to make a determination of the costs to member companies of providing Automobile Insurance Coverage through the mechanism of Facility Association. The 1985 Act mandated that Facility Association was required to establish and implement a Plan of Operation for the purpose of carrying out its obligations. The terms of the Plan of Operation and amendments thereto have been, and are subject to, the prior approval of the Superintendent of Insurance. The terms of the present Plan of Operation have been approved.

The present Plan of Operation, essentially the very same one in effect during the last Facility Association hearing, specifically sets out the compensation regime for brokers and agents and for Facility Association's servicing carriers. That compensation regime is therefore specifically authorized by the Superintendent of Insurance. The Facility Association Plan of Operation is not subject to control or approval by the Public Utilities Board.

Article V of the Plan of Operation titled "Participation, Ratios and Sharing" provides, in part, that "...at the end of each fiscal year, profit or loss for each class of business shall be determined separately for each accident year in each jurisdiction in accordance with accounting procedures approved by the board". As confirmed by Mr. Simpson, these accounting procedures approved by the Facility Association's board of directors, recognize all of the revenue received by Facility Association through the residual market mechanism and all expenses incurred by Facility Association with respect to that same mechanism. As noted, other expenses are incurred directly in the hands of member companies and include, but are not limited to, taxes on

premiums, provincial health levies, association dues and the cost of capital engaged by member companies specifically for their individual share of the Facility Association's operations.

The statutory duty of the Public Utilities Board, therefore, is to make a judicious determination of the entire costs associated with the supply of insurance products through the mechanism of Facility Association such that rates charged by Facility Association will be adequate to compensate member companies for all costs associated with membership.

Insofar as representations by the Consumer Advocate or others propose that such automobile insurance rates be set reflecting, in part, perceived financial hardship for consumers or other criteria not relevant to a determination of the cost of supplying such insurance, such representations are outside the scope of the statutorily prescribed and approved Plan of Operation and are not relevant.

THE ACTUARIAL DEBATE

Expert actuarial evidence has unequivocally established that present rates are significantly inadequate. The Public Utilities Board's own actuarial expert, Paula Elliott, has reviewed the Facility Association filing and proposed an increase for Private Passenger vehicles of 24.4% and for Commercial vehicles of 30.7%. It is the obligation of the Board acting judicially to determine which expert opinion best reflects the future cost of delivering automobile insurance products provided by the member companies through the mechanism of Facility Association. With respect to the actuarial evidence, we propose to examine the areas where the experts differed, with a view to assisting the panel in its deliberations.

Although all aspects of the application advanced by the applicant are considered important, the dollar value of the various differences between the two actuaries' positions underlines the relative importance of specific differences and may afford the panel some understanding of the relative weight that might be attached to each individual component.

During the course of his evidence, Mr. Pelly confirmed that "on-level premium" for accident year 2001, (being the latest reported accident year written premium adjusted to reflect the current approved rate level) was

approximately $11,400,000 for Private Passenger vehicles, and approximately $623,000 for Commercial vehicles. These on-level premium values can be utilized to calculate the dollar value of the increases proposed by Eckler and by MMC for both rating segments. Applying the percentages of increase to 2001 Private Passenger on-level premium indicates that Eckler proposes an overall rate increase of approximately $4,708,200 for the Private Passenger segment, and MMC proposes an overall increase of approximately $2,781,600 for that same segment, representing a difference of approximately $1,926,400. This latter sum then is the value of the 17 percentage points identified by MMC as the difference between Eckler's Private Passenger proposal and MMC's alternative proposal. Of that amount, 12 percentage points, or approximately $1,360,000, is identified by MMC as associated with the difference related to the selection of Private Passenger Loss Development Factors. A further 3 percentage points, or approximately $340,000, reflects the difference related to Trend analysis. The difference associated with the analyses for Unallocated Loss Adjustment Expense Provision (ULAE) and Third Party Liability Experience, each represent approximately 1 percentage point, each having a value of approximately $113,000.

Similarly, applying the percentages of increase to the 2001 Commercial on-level premium indicates that Eckler proposes an overall rate increase of approximately $301,000, while MMC proposes an increase of approximately $191,000, representing a difference of approximately $110,000. Of that amount, approximately $93,000 relates to the difference in Commercial Trend, approximately $12,000 is associated with the selection of Commercial Loss Development Factors and less than $4,000 is associated with the difference with Commercial Unallocated Loss Adjustment Expense Provision (ULAE).

ACTUARIAL POSITIONS AS TO PRIVATE PASSENGER INCREASES

a. **Loss Development Factors**

One aspect of the actuary's work in the rate setting process is to value existing unpaid claims; including those which have not yet been reported. The actuary needs to make provisions for the development of these existing unpaid claims to their estimated ultimate value. The

tool used to recalculate these unpaid claims is the Loss Development Factor. The selection of Loss Development Factors requires actuarial judgment involving the grouping of claims into cohorts by year of occurrence and a determination then of the number of years of experience which is to be directly included in the analysis.

Having determined the historical period to be directly included in the analysis, the actuary then looks at individual historic data points to determine if there are data points which are outliers, i.e., data points which are not representative or characteristic of what is expected in the future. If outliers are found, they are excluded from the calculations of data point averages for determination of the particular Loss Development Factors at each development interval.

In general, MMC's review of the Facility Association's filing concludes that methodology and assumptions used by Facility Association were sound and well documented. Specifically, MMC found the use of a 5 year average for selection of Private Passenger Loss Development Factors to be reasonable. They took exception only with the exclusion of certain data points from within that 5 year history. Although MMC also expressed a preference for the use of a weighted average, Ms. Elliott confirmed that the use of a simple average by Eckler did not, in her opinion, constitute a disagreement as to methodology; the weighted average was simply a matter of preference. In any event, it appears to be agreed that the use of a weighted average in the present circumstances would not contribute to any significant difference in the conclusions reached by MMC and Eckler. As a consequence, the $1,360,000 difference associated with the selection of Private Passenger Loss Development Factors is linked directly to the exclusion of certain data points by Eckler in the Loss Development Factor selection process.

Mr. Pelly spent considerable time explaining his rationale for his conclusions in this area. He also described how he undertook his work in the rate setting context for Facility Association. He testified that his report is prepared on a "best estimate basis" seeking to fix indications at the middle of any range (BGP #3, page 12 is a graph prepared by Mr. Pelly which depicts the Private Passenger development data for 15 years). Mr. Pelly testified that if a particular data point available for consideration in the selection of Loss Development Factors was not characteristic of what is expected in a

future period, then it was appropriate to exclude that non-characteristic data point from the average for selection of Loss Development Factors. Mr. Pelly noted that he followed the same philosophical approach in the present filing and in the preparation of the Facility Association 2001 Rate Application. He further noted that the report by MMC with respect to the 2001 Application found the selected Loss Development Factors to be reasonable. It is noteworthy that the 2001 rate filing also excluded certain data points considered by Eckler to be outliers for the selection of Loss Development Factors. In the 2001 filing, Eckler also selected Loss Development Factors for Private Passenger analysis using a non-weighted average. As Mr. Pelly indicated in his evidence, Eckler philosophically followed the same general approach in the 2002 Rate Application as had been followed by them in the 2001 Rate Application. For reasons that he was unable to explain, the approach which was found by MMC to be reasonable in 2001, was found to be unreasonable in 2002.

Mr. Pelly acknowledged that identifying an outlier is a judgmental process in which actuaries routinely engage. The whole actuarial effort contemplates that assumptions will be made that will lead toward developing an indication that is relevant in the future. Again, he testified that if a data point is not characteristic of what is expected in the future, then it is appropriate for that data point to be excluded from the average in generating a Loss Development assumption. The chart at BGP #3, page 12, and certain of the subsequent charts were intended to depict the historical range of data points over time. The data points older than 5 years are shown as yellow data points on that chart. Although the yellow data points are not included within the average, they do provide additional historic context. The data points within the last 5 years are shown either as blue for included data points or black for excluded data points. There is a judgmental effort to determine whether a particular data point is within the neighbourhood of recent and longer term history in determining whether it is an outlier.

Looking specifically at the Private Passenger, Bodily Injury segment at Appendix "A", Tab 4.4 of the filing, and at BGP #3 at page 12, the filing and the chart identify five data points from the total of 65 data points within the latest 5 year history which Mr. Pelly considered to be outliers, and which he therefore excluded.

Moving from the oldest interval to the most recent interval, the first data point was excluded in the tenth column being the 84/72 month interval. The excluded data point, 0.9025, was the lowest of the five data points within the latest 5 year history. That excluded data point was also the lowest recorded data point for that interval since at least 1986. As the chart depicts, the other four data points in the recent 5 year history are very closely clustered.

In the next 72/60 month interval, no outliers were observed and no data points were excluded. All five data points for that interval are tightly clustered. In the next interval for 60/48 months, a further outlier is identified. It is the lowest of the data points in the latest 5 year history, and with one exception, is the lowest data point since at least 1986 at that interval. Only one lower data point is identified as a yellow marker. It represents a data point for 1989. All of the four remaining data points within the latest 5 year history are tightly clustered.

In the next interval for 48/36 months, two outliers are identified. They are the two lowest data points in the latest 5 year history and are the two lowest data points for all history at that interval since at least 1986.

In the next interval for 36/24 months, a further outlier is identified. It is the lowest data point in the latest 5 year history. Again, it is also the lowest data point for all history at that interval going back to at least 1986. The remaining data points at that interval within the 5 year history are again tightly clustered.

In the most recent 24/12 month interval, no outlier is identified. One data point is visually above the other four tightly clustered blue data points for the most recent 5 year history. It is not identified as an outlier and not excluded. Mr. Pelly explained his judgment in this regard. He advised that the first column is the interval where you are going to have the biggest development because claims there are the most immature. He stated that there would naturally be more randomness in the factors at that interval and they would be gravitating to a higher value than would be the case in subsequent intervals for this coverage. Importantly, he also noted, was the abundance of historical values that appear near and above that blue dot that was not excluded. Mr. Pelly observed that the data point

represented by the highest blue dot was not an outlier relative to the longer term history. In fact, he said, there was a lot of history in that vicinity. That is what distinguished that blue data point from the excluded black points which he noted did not have supporting historical context and historical comparative values.

In the MMC 2002 review of the Facility Association's Private Passenger filing, Ms. Elliott took issue with the "judgmental exceptions made by the FA in the case of bodily injury". She recommended selections of Loss Development Factors without **any** data exclusions. In the context of Private Passenger Third Party Liability Bodily Injury Loss Development Factors, Ms. Elliott particularly identified the high data point in the most recent interval which was not excluded. Because no high data points were excluded, she appeared to be unwilling to accept that any low data points could be excluded. She opined on a number of occasions that excluding only low data points was not a balanced approach. The overall impact of her evidence, we submit, is that no judgment is exercised other than determining the number of years to be utilized in developing the average. When pressed on the issue she said that the data points were part of the history; they had occurred and could possibly occur again. Ms. Elliott, although acknowledging in her evidence that the selection of Loss Development Factors is a matter of actuarial judgment, made no effort to identify outliers, she simply included every data point in the 5 year history. This approach represents, we suggest, the absence of actuarial judgment. On any number of occasions in her evidence, Ms. Elliott appeared to conclude that unless a data point could be shown to have been a "mistake" or determined in "error" it could not be excluded.

For portions of her cross-examination on this topic, Ms. Elliott actually claimed that no data point could be excluded unless the actuary could go back and track that data point going to each of the individual servicing carriers to try and find out if there is an event or a claim or a transaction in a particular year which explains that unusual data point. Later in her cross-examination, she moved away from this position and, we submit, re-adopted a rigid rule that no data point should be excluded because each data point was part of the history and could therefore occur again. The only "high" point which was not excluded for Private Passenger Third Party Liability Bodily Injury Coverage was, it appears, the blue dot data point in Mr. Pelly's BGP

#3, page 12 chart at the first (i.e. 12/24 month) interval. She offered no response to Mr. Pelly's evidence other than she would not exclude low data points unless she could also exclude high ones.

This refusal to focus on outlier data points in the Loss Development Factor selection was very clearly inconsistent with the approach she adopted in her 2003 Benchmark Commercial Trend analysis. There she excluded four data points, including the second data point in 2000 and the first data point in 2001, relying, it seemed, on an intuitive conclusion which we suggest was not supported by the evidence. Interestingly, three of the four data points she excluded, were high. In the equivalent 2002 MMC Benchmark Commercial Trend analysis she excluded only one high data point.

Again, it is noteworthy that the difference of opinion between Mr. Pelly and Ms. Elliott in the context of Private Passenger Bodily Injury Loss Development Factor selection is the single most significant difference in the value of their respective judgments. This single disagreement accounts for approximately 70% of the difference in opinion between Mr. Pelly and Ms. Elliott in the determination of the appropriate indicated rate for Private Passenger vehicles. It represents approximately $1,360,000 of the approximately $1,927,000 difference in the actuaries' proposals.

One of the more peculiar examples of MMC's refusal to exclude any data points as outliers for the selection of Loss Development Factors arose during the course of Ms. Elliott's evidence associated with Commercial Vehicles Collision Coverage. She was asked to consider the exclusion of the data point in the forth interval for Commercial Vehicles Collision Coverage. The Loss Development Factor selection and that particular data point are depicted in BGP #3 at page 28. While Ms. Elliott initially suggested that MMC did not offer a different rate for this coverage, she later realized that MMC had in fact proposed a lower rate. Asked to explain why she did not agree with the exclusion of the data point identified as an outlier in the forth interval by Mr. Pelly, she acknowledged that the point was low for that particular column. She stated, "I didn't say that it doesn't look like an outlier". It appears her reason for leaving in the data point was to maintain what she called a "consistent approach". That consistent approach is quite obviously a rigid position that no data point whatever is excluded, regardless of whether it in fact is an

outlier relative to other data points. As she indicated, that particular data point was part of the history. It did occur, and therefore, she reasoned, might occur again. The rigidity of her approach to the selection of Loss Development Factors is more fully dealt with in the discussion on Commercial Vehicle Collision Coverage.

It should be noted that the charts depicted in pages 1, 2, 3, 4 and 5 of PLE #4 are significantly different in their scope than comparable charts in BGP #3. The charts in BGP #3 show all 15 intervals on the horizontal axis and a wide range of Loss Development Factors in the vertical column. By comparison, those charts in PLE #4 contain between 3 and 5 intervals only on the horizontal axis and therefore depict much less data relevant to the analysis. It should be noted as well that time intervals on the horizontal axis do not equate to years for purposes of the 5 year history that MMC recognizes is appropriate to the examination. The 5 year history is the past 5 years at each of the 15 interval points. As a consequence, for example, the first chart at PLE #4 does not depict any loss development data for periods prior to the last 5 accident years, (i.e. Mr. Pelly's yellow data points), it does not even depict the fifth excluded data point in the sixth interval as evident in BGP #3 at page 12. It is our submission that the charts containing PLE #4 are not particularly helpful in that they do not reveal and disclose all of the series of intervals which are relevant even to the MMC 5 year history. Ms. Elliott, in her evidence, indicated that these were showing only the 5 year average. Her evidence was to the effect that the first chart at PLE #4 showed the "5 year average", in fact, it shows only the 5 year average for 5 of the 15 intervals relevant to that 5 year history.

b. **Trend**

In addition to claims development, there is as well a recognizable pattern of change in historical claims experience over time. Mr. Pelly likened that pattern of change to "claims inflation". He confirmed that Eckler utilized objective statistical tests and statistical regression techniques to analyse historic Newfoundland Industry Experience to extract information and to build an understanding about the longterm patterns of change. Trend factors are generated using these tests and techniques which are then used to restate historical data so that it is relevant to the future rating period for which rate adjustments are being considered.

With respect to Private Passenger Trend analysis, MMC identified four concerns with Eckler's judgments. MMC did not provide a breakdown of the relative value of these Trend issues. While we know the value of the overall Private Passenger Trend difference is approximately $340,000, we do not know specifically the amount that relates, for example, to the half-year data issue, or specifically, to the other three identified concerns. Although small, compared to the difference in values related to the selection of Private Passenger Loss Development Factors, this item nevertheless carries a larger dollar value than the combined dollar value of all the differences associated with the Commercial automobile segment of the filing.

i. **Half-Year Data**

The first concern relating to the use of Annual Accident Year Data as compared with Accident Half-Year Data would, unlike the case with Commercial rates, appear to have had minimal impact on the difference in the determination of indicated Private Passenger rates. In the Private Passenger filing, Eckler did not exclude any data points from the Third Party Liability Bodily Injury Coverage. The Private Passenger Third Party Liability Property Damage Coverage was split into severity and frequency for Trend analysis. One data point only was excluded in the frequency analysis for 1992. No data point at all was excluded in the severity Trend analysis. Consequently, of the 48 data points considered in the Private Passenger Third Party Liability Coverage, only the 1992 property damage data point for frequency was excluded.

Third Party Liability, at approximately 82%, constitutes the major portion of Private Passenger premium. We can only approximate that Third Party Liability represents 82% of the $340,000 of Trend difference, Collision approximately 10% and Comprehensive, Accident Benefits, Uninsured Auto and Specified Perils each at 3% or less for a total of approximately 7%.

MMC argued that the use of Half-Year Data adds precision to the Trend analysis. Mr. Pelly disagreed with this opinion, and of course, his analysis was based on annual data. Mr. Pelly testified that the use of Accident Half-Year Data serves to

complicate the Regression Model. Aside from that general concern, Mr. Pelly's primary objection to the use of Half-Year Data in this case is based upon the relative size of the Newfoundland driving population. In his opinion, the use of Accident Half-Year Data in this jurisdiction raises concerns with the credibility or reliability of data. Mr. Pelly referenced the comfort associated with what he referred to as the law of large numbers. When the yearly numbers are divided, more inherent variability or potential for variability may exist, and as a consequence, in his opinion, there would be more noise, meaning distortion and randomness in Accident Half-Year Data. Mr. Pelly acknowledged using Half-Year Data in the Province of Ontario, but, in his opinion, the comparatively larger driving population allowed the use of Accident Half-Year Data in that jurisdiction without raising issues of credibility or reliability. Essentially therefore, the size of the driving population in this jurisdiction may lack sufficient critical mass, and in Mr. Pelly's opinion, discourages the use of Half-Year Data for trending purposes.

A similar methodology was recommended by MMC in the Commercial context. Our comments in that area apply with similar force to the discussion in the Private Passenger context.

Mr. Pelly provided considerable evidence in connection with the statistical regression techniques including the R Square and R-Bar Square results obtained in both approaches. He established the MMC R Square and R-Bar Square results were in every case inferior to those developed in the filing, and in many cases, the seasonality T statistic failed, sometimes by a considerable margin, raising the question whether the MMC Regression Model is actually capturing seasonality or noise in the data.

In her direct evidence, Ms. Elliott testified that she derived essentially the same annual Trend rate whether she used Half-Year Data or annual data. On cross-examination, she testified that when quantifying Trend with comparable data (meaning without any data exclusion) on either a half-year basis or on an annual basis, the Trend is always substantially equivalent. If the MMC regressions are failing the seasonality T statistic, one

wonders what is the intuitive justification for use of the Half-Year Data at all, especially considering the associated concerns and risks identified by Mr. Pelly.

ii. **Number of Years of Historical Data included in the Regression**

In its report, MMC opined that a more appropriate balance between stability and responsiveness of Trend factors would be achieved by giving less consideration to the experience of older years. Mr. Pelly agreed that the number of years to be used in developing the regression is a matter of judgment, and in making that determination, he looks to see how well a regression performs. One of the methods of measuring the adequacy of a regression is the use of statistical tests. As mentioned, the Eckler Model, in every case, provided superior R Square and R-Bar Square results. As Mr. Pelly testified, the use of periods of inadequate duration for the trending analysis exposes the risk of very significant shifts and fluctuations moving from one year's analysis to the next. Mr. Pelly acknowledges that underlying Trend is a long-term phenomenon, and even using long periods for analysis of Trend can sometimes leads to significant shifts in forecasted Trend, underlining the risk of adopting shorter periods.

iii. **The Unemployment Variable**

Mr. Pelly testified that, in principal, the actuary is looking to determine whether or not an economic cycle or in this case an Unemployment Variable, as a surrogate therefor, has any correlation with claims experience. In his opinion, there was an intuitive explanation and justification for the use of that variable in the analysis of certain coverages. In times of high unemployment, he suggested drivers may use their vehicles less frequently resulting in a correspondingly lower frequency of property damage. Mr. Pelly testified that for every coverage for which Eckler developed a trending estimate, they also test the statistical significance of including the Unemployment Variable to capture the influence of the economic cycle. As he explained, for most coverages it is not significant, but for some it is. It usually arises, he said, in regressions on frequencies.

He observed, in fact, that the Regression Model for Private Passenger Third Party Liability Property Damage frequencies recommended by MMC which exclude the Unemployment Variable was borderline meaningless. He also testified that Eckler looked for evidence of a statistically strong relationship between unemployment rates and the statistics that were being fitted, either loss cost, frequencies or severity, and found that unemployment was a statically significant variable only for Private Passenger Third Party Liability Property Damage and Collision frequencies. He noted that the Unemployment Variable was not a statistically significant variable in the Private Passenger Bodily Injury Coverage Regression. Reference to the chart at page 16 of BGP #3 for Third Party Liability, Property Damage frequency provides particulars of the relative statistical values coming out of the Eckler and MMC Regression Models with the Eckler regression, which in this case incorporates the Unemployment Variable, demonstrating a considerably better fit.

Ms. Elliott's objection to the use of the Unemployment Variable turns, it appears, on the fact that the rate is dependant upon a forecast provided by another source and that frequency is sensitive to the Unemployment Variable. Presumably, the latter is only a problem if the forecasted rate is unreliable. Mr. Pelly confirmed that his firm relies on the Conference Board of Canada for this forecast. Ms. Elliott offered no basis to suggest that the Conference Board forecasts are untrustworthy.

This seems a peculiar concern when the whole of the actuarial process is itself nothing more than a forecasting exercise. In MMC's preparation of the 2003 Newfoundland Benchmark (which we now understand was not adopted by the Public Utilities Board) MMC confirmed that it relied on outside data and information in that benchmark analysis. Specifically, they confirmed that the analysis was based on data supplied by IBC and by the Insurers' Advisory Organization, and by earlier benchmark analysis by Milliman & Robertson. Of very particular note, the MMC 2003 Newfoundland Benchmark report confirms (at page 23) that MMC "*used a Loss Trend Regression Model to estimate the annual frequency, severity and loss cost trends by coverage, based on several parameters that include*

time, seasonality, and the Newfoundland unemployment rate as estimated and forecasted by the Conference Board of Canada". In her evidence in the present hearing, she referenced this Newfoundland unemployment rate as a "big unknown to enter into the Model". Clearly, however, the Conference Board of Canada Newfoundland unemployment rate forecast is as reliable in the Newfoundland benchmark analysis as it is in the Facility Association rate filing.

iv. **Comprehensive Flat Frequency Trend**

The observation made by MMC in its report is to the effect that Facility Association's Regression Model produced an annual frequency Trend rate for Private Passenger Comprehensive Coverage of -6.8%, and yet, Facility Association judgmentally selected a future frequency rate at 0%. MMC suggests that this approach was unreasonable when the regression indicated a negative Trend. The Eckler position is depicted in BGP #3, p.24. That graph discloses the generally downward frequency Trend in this area of coverage from 1990 through 1996. Mr. Pelly, however, points out that from 1996 through 2001 the frequency is essentially flat. As he indicates, the purpose of the Trend analysis is again to build an expectation for the future, and in his opinion, claims frequencies within this component will not continue to decline indefinitely. They must bottom, he concludes, at some point in time, and as he observes, the recent historical data is not showing a continuation of the earlier decline. He could not fathom continuing a projection of declining frequencies beyond historical levels, lower than ever recorded in the history for this coverage, when the recent 6 years discloses a general flatness.

Two observations might be made in relation to this issue. Firstly, the on-level premium for this coverage as demonstrated in Appendix "A" of the filing document at Tab 7 is only $346,000. It represents, therefore, only 3% of the overall Private Passenger vehicle premium. Facility has actually filed for an indicated decrease in this coverage at -14.1%. MMC suggests that the indicated adjustment is -17.3%. Using the 2001 on-level premium data, the indicated decrease in the Facility Association filing is approximately $49,000, and

the MMC indicated decrease is approximately $60,000. This represents a total difference of approximately $11,000. This item represents a very tiny portion of the Private Passenger Trend difference between the actuaries.

Secondly, in her own 2003 Newfoundland Benchmark Analysis for Accident Benefits Coverage, Ms. Elliott judgmentally set Trend at 0%, notwithstanding that the regression indicated that severity was declining, and in fact at a negative value. She judgmentally determined that essentially the negative Trend value did not make sense to her.

This is similar to the objection raised by Ms. Elliott with respect to the Unemployment Variable where in her analysis of the Facility Association filing, she objected to the very same approach which she had herself adopted and utilized in the preparation of both her 2002 Newfoundland Benchmark and her 2003 Newfoundland Benchmark reports.

c. **Unallocated Loss Adjustment Expense**

The next area of actuarial disagreement in the Private Passenger segment of the Facility Association filing related to the issue of Unallocated Loss Adjustment Expense Provisions (ULAE). The issue relates to the subsequent availability of more current data. As is apparent from Mr. Pelly's evidence, the filing, when prepared, used the most current data that was then available. Mr. Pelly recognizes that new data is continuingly becoming available, but that the process of developing rate indications does take significant time. We again note that this particular difference between the filing prepared by Eckler and the recommendations by MMC represents approximately 1 percentage point of the approximately 17 percentage points of difference between the two actuaries. The value of this item, therefore, represents approximately $113,000 of the overall difference of approximately $1,926,000 in the indicated increases for Private Passenger vehicle rates.

d. **Analysis of Third Party Liability Experience**

According to MMC, this item of disagreement also represents approximately 1 percentage point of the approximately 17 percentage

points of difference between the two actuaries in the Private Passenger segment of the filing. Like the ULAE Provision difference, it therefore represents approximately $113,000.

The MMC analysis recommends that in determining rate level needs for Third Party Liability, experience for bodily injury and property damage components should be analysed separately throughout. They suggest that the separate analysis improves the credibility of the experience. As the MMC report states however, when the experience is combined, a credibility weight of 97% is achieved for each component. Their report states that the separate analysis, while producing a credibility weight of 100% for property damage, provides a credibility weighting of only 51% for bodily injury. Mr. Pelly further testified that while he is open to exploring the possibility, he cautions that the approach for restatement that MMC proposed was limited in its analysis because MMC did not have access to the long history by virtue of their relatively brief role in this process. As he noted, an actuary would need to spend time building up some of the values that are used for the balance of credibility when these two components are split. Because of the concerns with the credibility for bodily injury, he advises that Eckler would have to revisit the full credibility standard that is used for the coverage, and they would need to reassess the criteria that would be used for the balance of credibility, and in particular, the loading that is applied to industry data to recognize the extra inherent riskiness associated with the Facility Association experience. As he testified, this would require very careful scrutiny and study to build up a reasonable foundation to use as a starting point to adopt this approach. Mr. Pelly's concern is that Eckler has not yet conducted that study, and in his opinion, the information necessary to construct a context for making the change was unavailable to MMC. It is also interesting to note, as Mr. Pelly points out, that the Board's previous actuary disagreed with the extent to which Eckler was even at that time separating the analyses of these two components. It was Milliman & Robertson's position, he testified, that it was essential that the two components be analysed on a combined basis. Accordingly, while Eckler is open to investigating this suggestion, it would be untimely to modify the indicated rate increase without that careful scrutiny and study first occurring.

ACTUARIAL POSITIONS AS TO COMMERCIAL

INCREASES

As is apparent from the evidence of both Mr. Pelly and Ms. Elliott, Facility Association's Commercial vehicle premium is significantly less than that for Private Passenger. Accordingly, the dollar value of the proposed increases for Commercial Coverage is significantly lower than that for Private Passenger.

The differences in the approaches taken by the two actuaries within the Commercial segment are similar to some of the same concerns that were raised in the Private Passenger segment. The emphasis, however, is on different issues within this segment. As the MMC report indicates, the total difference between the two actuarial reviews within the Commercial segment amounts to approximately 17.6 percentage points, and as previously noted, that percentage represents approximately $110,000 of difference in the suggested rate increases within the Commercial segment. As the MMC report states, 15 of the percentage points in this category, or approximately $93,000 in difference, occurs by virtue of the differing views on Loss Trend rates. As a consequence, the Trend rate, which was a relatively minor component of the difference in the Private Passenger segment is the major component of the difference in the Commercial segment. The MMC report also states that approximately 2 percentage points of the difference relates to the differing views between the actuaries on the selection of Loss Development Factors. As previously noted, that would constitute a difference of $13,000. Finally, approximately one-half percentage point relates to the difference of opinion on the Unallocated Loss Adjustment Expense Provision (ULAE) and that, therefore, equates to a difference of about $4,000 in premium increase. Again, the total value of all of the differences in the Commercial segment are less than the value associated with even the most minor difference in the Private Passenger segment.

e. **Loss Development Factors**

Mr. Pelly provided charts at pages 25, 26, 27, 28 and 29 of BGP #3 depicting the Loss Development Factor selection for each of bodily injury, property damage, accident benefits, collision and comprehensive in the Commercial context. The chart on page 25 depicts the data points utilized for the selection of Loss Development Factors for the Commercial vehicle bodily injury component. As evident from the graph, of the 65 data points contained within the latest 5 year history, one data point only was excluded. As depicted

in the graph, the excluded data point stands entirely alone from all other data points within the last 5 years at that interval. It also stands alone from all data points at that interval since at least 1984.

The chart at page 26, dealing with Commercial vehicle Property Damage, reveals that of the 65 data points contained within the latest 5 year history, only two were excluded. Those two data points are again the lowest data points within the last 5 years at that particular interval.

The Commercial Accident Benefits graph at page 27 reveals that there were no data points excluded from the Loss Development Factor selection, and as is evident from the material depicted on that graph, there are, from a historical perspective, many historical data points above and below those depicted for the last 5 years. This graph is helpful to indicate the extent to which Eckler is motivated to avoid excluding data points where, even though the data points may appear to be high or low looking at the most recent 5 year history only, the longer history reveals extensive data above and below the range revealed for the most recent 5 years. Consistent with the exercise of good actuarial judgment, Mr. Pelly declined to exclude any of the data points identified in blue.

The graph at page 28 for Commercial Vehicle Collision Coverage reveals that two data points were excluded, one in the second interval and one in the fourth interval. In both cases, these data points at those intervals, and at every interval after the most recent interval, are to a very substantial degree, isolated from the other data points, both within the 5 year history and within the broader history going back to at least 1984.

Ms. Elliott was questioned at some length about this page 28 chart, and in fact, finally acknowledged that the excluded data point, for example, in the fourth interval, was low for that particular column. When asked specifically why she would not agree that that data point was an outlier, her response was, " I didn't say that it doesn't look like an outlier", and in fact, she finally agreed that, in isolation, this data point is alone, and all other data points are distant from it. It was in the context of that discussion that we submit Ms. Elliott revealed her true position with respect to Loss Development Factors. Her true position is that she is not prepared to exercise any actuarial judgment

for the exclusion of outlier data points. She agreed that her approach really comes down to the application of a rule across the board that she will exclude nothing from the 5 year history.

The graph at page 29 for Commercial Specified Perils Coverage reveals as well that there were again only two data points excluded from the 65 data points within the latest 5 year history. These obviously were the two lowest data points at the first interval. It is worth noting that this particular coverage represents less than .2 of 1% of the total on-level premium for Facility Association for accident year 2001.

f. **Trend**

As indicated, the total dollar value difference in the positions taken by the two actuaries on Commercial Trend amounts to approximately $93,000. As MMC notes in its 2002 Facility Association Review Report, they find that the Facility Association Model with respect to Loss Trend rates to be sound and reasonable. They concluded however that Facility Association's estimated Trend for bodily injury in the Commercial sector was unreasonably high. They also objected to the selection of Flat Future Frequency Trend for Property Damage-Tort and for Collision Coverages.

As to the first Commercial Trend issue, MMC's conclusion is based entirely on its position that the data for the last half of 2000 and the first half of 2001 is inflated as a result of the winter conditions in those two half-year periods. That experience has been completely removed from the MMC Regression Model and accordingly Commercial rates recommended by MMC already reflect the exclusion of those data points from the MMC Trend analysis. There is, however, considerable difference of opinion as to whether those two half-year data points are statistical outliers and whether there is any intuitive explanation that would support the MMC theory. As Mr. Pelly testified, the Eckler regression curve did not identify the winter of 2000-2001 as being unusual or as being uncharacteristic of the flow that the earlier data was demonstrating. Mr. Pelly made specific use of the page 30 chart in BGP #3. That chart deals with the issue of Commercial Trend and focuses on the 2000-2001 winter. The chart reflects the annual data points and the MMC and Eckler fitted lines for Commercial Third

Party Liability Bodily Injury Loss Cost. As Mr. Pelly testified, the data points for 1993 and 1998 were excluded by Eckler based on Eckler's statistical outlier test, but 2000 and 2001 were not flagged as being outliers, and the regression, he testified, was a strong performing regression with those data points included. The only reason offered by MMC for the exclusion of those two data points is their perception that the winter storm in that period caused an aberration. Mr. Pelly testified that there was a lack of support for this theory when one examines the loss cost data for the Private Passenger segment for that same period. As Mr. Pelly points out, the same storm would also have affected Private Passenger vehicles. He notes that MMC did not suggest any necessity for the exclusion of those same half-year data points in the Private Passenger analyses. Mr. Pelly was unable to accept that the winter storm could have focussed its impact only on Commercial vehicles. It was Mr. Pelly's evidence that the statistical analysis of the pattern change through time did not flag those data points as outliers in the Eckler regression, and consequently, they were not excluded.

The evidence presented by R.N.C. Sargent John Hill suggested that there was an increased frequency in motor vehicle accidents during the last half of 2000 and the first half of 2001. A number of observations can be made with respect to that and as to its value in determining whether the exclusion of those half-year data points by MMC is justified as a result of a perceived harsher winter. It is noteworthy that the exclusions of both these data points was not carried forward into the Trend analysis for other Commercial Coverages. Specifically, for example, the exclusion of the data point for the second half of 2000 was not carried forward into the Third Party Liability Physical Damage Coverage. Neither of those data points were excluded in the Accident Benefits or the Collision Coverages analyses. The exclusion of the data point for the first half of 2001 was not carried into the analysis for Comprehensive Coverage. This is extremely peculiar, particularly on the issue of the Third Party Liability Property Damage Coverage where the first data point is not excluded. The MMC argument would therefore tend to suggest that there were an increasing number of Commercial vehicle accidents in the second half of 2000 which did not result in property damage, but did result in bodily injury claims.

Also of particular importance is the acknowledgement by Sargent Hill

that his accident records do not disclose whether the increased accident frequency during these 2 half-year periods involved Private Passenger or Commercial vehicles. He could offer no evidence as to the relevant percentages of Private Passenger vehicle accidents as opposed to Commercial vehicle accidents, nor could he offer any relevant evidence as to the percentages of Private Passenger vehicles and Commercial vehicles on the roadways within the jurisdiction of the R.N.C. at those particular times. The jurisdiction of the R.N.C. of course, as is evident from Sargent Hill's evidence, does not include all of Territory 1, and as a result, is incomplete in any event. Sargent Hill as well had no evidence on the severity of the accidents during the two pertinent periods. Although that information was apparently within the ICAN data bank, it was apparently not information that he was asked to provide at the request of the Consumer Advocate. Sargent Hill also admitted that the information that he was able to present did not include any of the other areas outside of the Avalon Peninsula within the policing jurisdiction of the R.N.C. Sargent Hill's evidence as well did not reveal that the increased frequency in accidents that he had noted actually occurred during stormy weather conditions.

The deficiencies in information supplied by Sargent Hill and the absence of any corresponding result in the Private Passenger sector, justifies Mr. Pelly's conclusion that there is no evidence that the increased frequency is necessarily related to more severe winter conditions for those two half-year periods. This information, together with the absence of these two half-years being revealed as outliers in the Eckler objective test or in the Eckler regressions for this coverage, serve to emphasize Mr. Pelly's concerns, generally with half-year data and the absence of any compelling intuitive justification for the exclusion of those two half-year data points.

As already indicated, this first Commercial Trend issue is very directly linked to the MMC preference for the study of half-year data rather than annual data for Trend analysis in the Private Passenger and Commercial context. She testified that if she had not split the data into half-year portions, these two points would not have been identified as unusual. Ms. Elliott claimed that the use of half-year data demonstrates the implication of seasonality evident in the data. She testified that the up and down nature of seasonality can be seen graphically. She claimed that it does not require a statistician to

recognize the seasonality. The up and down nature, she said, is due to the differences in the experience between the first half of the year and the second half of the year.

One would presume that if Ms. Elliott was prepared to factor a variation for seasonality into her analysis, there would be an intuitive or common sense expectation as to how and why it would work. Simply put, it should be explainable. Surprisingly, Ms. Elliott, initially in her cross-examination, could not offer any particular seasonal expectation, i.e. loss costs generally higher in the first half or the second half. When she looked at the half-year data during cross-examination, she finally concluded that seasonality occurred in the second half of each year. What she meant by that, she said, was that the higher loss costs would be seen in the half-year period between July and December. This seemed surprising as it, of course, suggests the higher loss costs do not occur during the portion of the year that comprises the bulk of the winter period. At the very least, one would expect that the actuary would have formulated an intuitive understanding which would justify the conclusion that is being reached on the interpretation of the data broken down half yearly.

Looking at the data contained in Consent #1, from the first half of 1990 through the second half of 2001, the up and down nature which Ms. Elliott suggests should be apparent, is less so. In fact, during the 24 cycles within that period, the "down pattern" in the first half of the year and the "up pattern" in the second half of the year, suggested by Ms. Elliott to be readily evident, was actually evident only two-thirds of the time. An inconsistent pattern is evidenced on a full one-third of those data points. In the second half of 1990, the loss cost is up from the first half and then down in the first half of 1991 and up again in the second half of 1991. These variations are consistent with Ms. Elliott's suggested seasonality. The first half, however, of 1992 should have been down, it was actually up. The second half should have been up, it was actually down. Similarly, the first half of 1993 should have been down, and it was up. These three data points are therefore inconsistent with Ms. Elliott's seasonality expectation. The second half of 1993 was up. The first half of 1994 was down. The second half of 1994 was up. The first half of 1995 was down, and the second half of 1995 was up. Again, these are data points which are consistent with Ms. Elliott's seasonality expectations. However, the first half of 1996 was up and it should have been down. The second half of 1996

was down rather than up. The first half of 1997 is up rather than down. Consequently, these three data points are also inconsistent with Ms. Elliott's seasonal expectation. The second half of 1997 is up; the first half of 1998 is down; the second half of 1998 is up; the first half of 1999 is down; the second half of 1999 is up. These data points are consistent therefore with Ms. Elliott's seasonal expectation. The first half of 2000 was up, contrary to the seasonal expectation. The second half of 2000 and the first half of 2001 are up and down, again consistent with her seasonal expectation. However, the second half of 2001 is down rather than up. This is again inconsistent with the suggested seasonal expectation. Accordingly, therefore, there are 16 data points which followed Ms. Elliott's seasonal expectation, and eight data points which did not. This hardly provides adequate consistency to justify her seasonality theory, and of course, the T-Test scores for seasonality, as Mr. Pelly pointed out, left a great deal to be desired.

As further support for her Commercial Bodily Injury Trend rate, Ms. Elliott claimed that with "*the same drivers on the roads in Commercial and Private Passenger*", intuitively, it was not unreasonable that the relationship between the Private Passenger Trend and the Commercial Trend be "*relatively close*". MMC developed a Trend for Private Passenger Bodily Injury at 7.1% and for Commercial Bodily Injury at 11.3% with the two data points for the Famous Winter included. The Commercial Trend rate, with the two data points included, Ms. Elliott observed was "*very different*" from the Private Passenger Trend rate, which intuitively, she said, did not seem reasonable. When she excluded the two data points, the Commercial Trend rate dropped 8.4%. The relative closeness of the two Trend rates at 7.1% and 8.4%, she concluded, provided "*comfort*". This reliance, however, upon relative closeness of Trend in the Private Passenger segments was not evident in Ms. Elliott's own 2003 Benchmark Trend Analyses. Her Private Passenger Accident Benefits Trend was 4.6% and her Commercial Accident Benefits Trend was19.7%.

The MMC Commercial Bodily Injury Trend Analysis does not appear to be either statistically or intuitively sound. Ms. Elliott uses the severe winter argument to prop up her half-year data theory, but the data in the Private Passenger segment provides no statistical support for the theory. Her intuitive claim that Trend values will be

comparable for Private Passenger Coverages and Commercial Coverages is not borne out in her own 2003 benchmark analyses for Private Passenger and Commercial Coverages. Additionally, the use of half-year data requires that annual data values be divided. The MMC 2002 report specifically recognized that for reasons of credibility and stability, Facility Association relied on Industry Newfoundland Data to determine Loss Trends, and therefore, to determine rate level indications. MMC recognized this as appropriate. Newfoundland Commercial Industry data includes only about 18,000 vehicles. To create half-year data, MMC must therefore break down this value into two components. The vehicle count value for each half-year data point is therefore one-half of the annual data value. This reduces the value to about 9,000 vehicles per data point, and provides a data point that approximates the number of vehicles in the Facility Association Private Passenger segment. That number was considered by Eckler as an inadequate data base to provide acceptable credibility and stability, and this view was accepted by MMC.

Further, one would intuitively expect that loss costs would be higher in the half-year when driving conditions are the most severe. This, it seems, is the very foundation of her argument that the "Famous Winter" explains the high loss cost for the second half of 2000 and the first half of 2001. Yet Ms. Elliott admits that her seasonality theory expects higher loss cost in the half-year from July to December. Finally, the seasonality that Ms. Elliott claims is evident graphically is at cross purposes with her expectation for a full one-third of the cycles depicted in consent number 1.

As Mr. Pelly demonstrated in BGP #3 at page 31, the MMC Commercial Bodily Injury regression failed the seasonality statistical T-Test, again raising the very real question as to whether inclusion of the seasonality regression variable is meaningful in the fit of the MMC regression curve. Ms. Elliott offered an interesting solution for this problem. She explained that she could get the MMC regression for this particular coverage to pass the T-Test if she went back and included an additional two years of data history in her regression curve. If she did this, she was pleased to report that her regression then achieved a satisfactory T-Test score. Unfortunately, she had to admit that the inclusion of the additional two years' data resulted in a higher Trend rate. In fact, she said, the inclusion of the additional

two years resulted in a Commercial Trend rate higher than adopted by Eckler. To bring the Trend rate down, she therefore had to exclude the two additional years of history. Accordingly, Ms. Elliott's dilemma is that if she excludes the two additional years, then she manages to achieve her lower Trend rate, but she fails the seasonality T-Test. If she includes the two additional years, she passes the seasonality T-Test, but gets a higher Trend rate than she wants to achieve. Her solution is to exclude the two additional years thereby achieving the lower Trend rate, and argue that her regression can achieve seasonality T-Test success by using the extra period of history for that one purpose. She apparently sees nothing strange or peculiar about this logic.

The second Commercial Trend issue relates to the MMC recommendation that Eckler should have assumed the continuation of the declining Trend frequency for property damage. This information and the proposals are depicted at BGP #3, page 32. Mr. Pelly's position on this coverage is similar to the conclusion he arrived at for the Private Passenger Comprehensive Coverage. He concluded there had been a pattern shift with the last 6 years of data essentially flat, and therefore not typical of the seven earlier years. As a consequence, Eckler chose to fit a regression line to the longer term view, but to cap its forecasting direction at the point where the claim frequencies had bottomed out, and to therefore forecast a Flat Frequency Trend going forward from that point. As Mr. Pelly testified, in due course, when there is additional data available and when a new pattern is indicated, they will then fit a regression line to the more recent data.

The third Commercial Trend issue is similar to the second. It relates to the MMC recommendation that Eckler should assume a declining Trend frequency for Commercial collision. This information and the proposals are depicted at BGP #3, page 33. Again, the position taken by Mr. Pelly in this area is similar to his conclusion for Private Passenger Comprehensive Coverage and to the conclusion for the Frequency Trend for Commercial property damage. Mr. Pelly recognized that there had been a pattern shift and that the last 8 years of frequency was essentially flat, or perhaps even increasing, and was not typical of the earlier history. As a consequence, Eckler chose to fit a regression line to the longer history and to cap its forecasting direction at the point where the Frequency Trend bottomed out, and

to thereafter forecast a Flat Frequency Trend going forward. Again he testified, when there is additional data available from which a new pattern emerges, they will again use a regression line to fit that more recent data. Mr. Pelly further noted that the Regression Model for future periods for this coverage actually suggested that there would be increasing frequency. Again, he was not prepared to embrace a forecast of increasing frequency, and again, chose to adopt a Flat Level Trend going forward.

g. **Unallocated Loss Adjustment Expense**

This is the final component of the difference in the indicated rate increases in the Commercial segment. As was the case in the Private Passenger segment, this issue relates to the subsequent availability of additional data. As Mr. Pelly testified, the filing, when prepared, used the most current data that was then available. Mr. Pelly recognized that fresh data is always becoming available, but that development of the rates for filing does take significant time. The MMC report identifies the value of this difference at approximately one-half of 1 percentage point of the overall difference of approximately 17 ½ percentage points. The dollar value, therefore, of the difference relating to this particular item is less than $4,000.

THE CONSUMER ADVOCATE'S ACTUARIAL EXPERT

As evident in the Intervenor's Submission dated 15 November 2002, KPMG's Claudette Cantin and Lois Ross were retained to advise the Intervenor and to prepare an Expert's Report in respect of this application. In that preliminary submission, the Consumer Advocate stated that as presently advised, he would advocate rejection of the application or variance of the rate increases sought by the applicant. To accommodate the Consumer Advocate, an extension to the timelines imposed for filing reports was allowed by the Board.

Under the terms of engagement of the Consumer Advocate, his expenses (including expenses for actuarial advice and the cost of the actuarial report) will be payable by the Board.

The Consumer Advocate's Experts requested, and were provided, an array of information and documentation by Eckler on behalf of Facility

Association. All information and documentation requested by the Consumer Advocate's actuaries, or by the Consumer Advocate himself, was provided. Ultimately, the Consumer Advocate chose not to submit an actuarial report.

On behalf of the applicant, it is submitted that the failure of the Consumer Advocate to obtain and file an actuarial report, is compelling evidence that either the Consumer Advocate was informed by the actuarial expert that such a report would not support the Consumer Advocate's position, or the report obtained did not support it.

It is well recognized that where a party fails to present evidence, which it was in the power of that party to present, then such a failure justifies the tribunal in drawing an inference that the evidence would have been unfavourable to the party to whom the failure is attributed.

Here, the Consumer Advocate either had, or could have had, a further Expert actuarial report dealing with the actuarial issues being considered by the Board. Time was made available, and expense was not an issue. It should be presumed that the Consumer Advocate's expert actuarial report would have supported the position advanced by the applicant's actuary.

It should be noted that KPMG were engaged by the Nova Scotia Utility and Review Board to review the recent Facility Association filing for that jurisdiction and to provide expert actuarial advice to the Nova Scotia Board in respect thereof. Subsequent to the conclusion of the evidentiary portion of the present hearing, the Nova Scotia Utility and Review Board filed its decision in respect of the Facility Association Nova Scotia Application. In the Order of the Nova Scotia Utility and Review Board dated 17 January 2003, the overall rate increase of 31.4% requested for Private Passenger vehicles, was approved at 27.8%, and the overall average rate increase of 50.5% for Commercial vehicles was approved at 47.8%.

The Consumer Advocate has conceded that he represents the 4% of the driving population in this jurisdiction who could be affected by the Facility Association Rate Application. While the Consumer Advocate may choose to limit his interest to that group, the Public Utilities Board is responsible to consider the application from the perspective of all of the interested parties. It has a broader duty. If the rates being charged through the mechanism of Facility Association are inadequate, there are adverse implications for the broader vehicle insurance market which have been addressed by many of the witnesses. Such rate inadequacy promotes the need for cross subsidization,

it impedes the effectiveness of the voluntary market and may well result in a decline in insurers willing to participate in this market with an attendant impact on competitiveness and fewer choices for consumers.

CLEAR

The proposal for the implementation of CLEAR related only to the Private Passenger vehicle segment.

It was originally intended that the filing of an application for the implementation of CLEAR be made in a stand-alone application to the Public Utilities Board. Facility Association was asked to combine the application for the implementation of CLEAR with a rate application, and as Mr. Pelly indicated, those instructions were followed. CLEAR is presently in use by Facility Association in Ontario and New Brunswick. With the recent approval in Nova Scotia, it has been approved for use by Facility Association in every other jurisdiction in which Facility Association operates except Newfoundland. None of the jurisdictions in which it is in use or for which it has been approved have imposed any capping or required a phase-in of its implementation.

MMC has concluded in its report that the proposed introduction of the CLEAR system of rating automobiles is reasonable. They did recommend that the Board consider imposing caps on premium changes that individual drivers will experience as a result of that implementation.

As noted by Mr. Pelly and Mr. Simpson, and concurred with by Mr. Anthony, a new dislocation study or phase-in requirements ultimately have significant cost consequences for consumers.

In advance of the presentation of the application for the implementation of CLEAR, Facility Association conducted a dislocation study. That study revealed that approximately one-third of one percent only of the vehicles insured through the mechanism of Facility Association would be subject to the dislocation threshold identified by the Ontario regulator as excessive. Mr. Pelly explained that this would represent only twenty-five vehicles. The dislocation study establishes that approximately 68% of drivers would receive a downward movement of rate if an application for CLEAR had been made on a stand-alone basis, approximately one-half of one percent would see no change in rate, and the balance would see some upward movement

of rate.

Mr. Pelly and Mr. Simpson both confirmed that the deferral of CLEAR to allow a new dislocation study or to order the implementation of CLEAR on a phased-in basis would be very expensive measures. They point out that there is an extremely high turnover in the Facility Association Book of Business, a characteristic which was also confirmed by Mr. Hickey and by Mr. Anthony. As well, Mr. Pelly indicated that the Facility Association insured fleet of vehicles tended to include more older vehicles which would be less impacted by the implementation of CLEAR. He also confirmed that this tendency toward an older vehicle fleet was a reasonably stable statistic.

As stated by Mr. Anthony and as confirmed by the documentation, the majority of the insurance issued through the mechanism of Facility Association is for Third Party Liability Coverage. As explained, that coverage is not impacted by the implementation of CLEAR, rather the impact is limited to the Physical Damage Coverages including Collision, Comprehensive and Specified Perils.

Mr. Anthony observed that, in his opinion, CLEAR was a very fair mechanism, and although his own company had not yet implemented CLEAR, he acknowledged that it was now very common within the industry generally and his own firm had last year changed its computer systems so as to accommodate its implementation.

THE CLEAN DRIVER DISCOUNT AND THE REVISED SURCHARGES SCHEDULE

The application proposes the implementation of a clean driver discount and modification to the schedule of accident and conviction surcharges. As Mr. Pelly testified, the new discount and the revised surcharges are presented as an integrated package and consistent with applications which are being advanced across all Facility Association jurisdictions. The same package has been approved in Ontario, Nova Scotia and New Brunswick (the New Brunswick clean driver discount was approved at 15%).

Although Facility Association has no control over which drivers are insured through that mechanism, it appears that approximately 60% of drivers insured through the mechanism of Facility Association are placed there for

reasons other than accidents and convictions. This package of discounts and surcharges therefore will directly benefit those people, and hopefully, these rewards and penalties will also encourage and achieve some level of driver behaviour modification.

As Mr. Pelly explained the proposed package will add approximately 1.3 percentage points to the rates in the Private Passenger segment and will add approximately 6.4% points to the rates in the Commercial vehicle segment. This difference may in part be a result of the fact that the proposed discount will not apply in the Commercial segment. As Mr. Pelly explained, the overall rates proposed already reflect these adjustments.

As Mr. Pelly explained, the modification to the surcharges is a carefully developed package, and any modifications must recognize the potential for illogical patterns of change as drivers move from one rating category to another. Mr. Pelly also explained that if alterations in the discounts or the surcharges schedule were introduced, then certain off-balance factors would need to be recalculated in order to generate the proper indicated rate increases.

SENIORS AND TAXI OPERATORS

At the request of the Consumer Advocate, considerable effort was expended by the applicant to obtain statistics for certain age bands of persons insured through the mechanism of Facility Association over the age of 50. The applicant was also required to obtain particulars of the extent to which taxi operators were insured through the mechanism of Facility Association. The implication in both requests is that these groups are disproportionately represented in the Facility Association mechanism. The information depicted in Facility Association's Response 2.0 to the Consumer Advocate's Information Requests and the statistics provided in Information #4 discloses that for persons age 50 and over, a disproportionately smaller percentage are insured through the mechanism of Facility Association than in the regular market. For the two age bands when there was a minor increase in the percentage for persons in Facility Association as compared to the regular market, no evidence was offered which would in any way suggest that those people were not there by reason of risk factors other than age. Mr. Hickey and Mr. Anthony both observed that they had not seen any indication that people were being placed in Facility Association solely as a result of age. Mr. Anthony observed that in cases where a policy is singled out for other

reasons, it is possible that age might thereafter also be a factor in the ultimate underwriting decision. It was Mr. Anthony's belief that seniors were not arbitrarily being placed in Facility Association solely on the basis of age. It is important to note that Facility Association rates after age 25 are completely age independent. Other factors being equal, a driver at age 26 pays the same rate through the Facility Association mechanism as a driver at age 106. Facility Association, in any event, does not select who will be insured through its mechanism. It takes all comers regardless of age and its loss cost analysis is a product of the collective experience, good or bad, of those drivers.

In respect to the issue of taxis, jitneys and liveries, the data submitted in DGS #1 confirms that, with one exception, Facility Association in Newfoundland has had the lowest market share for coverages for this group of all the Atlantic Provinces for accident years 1997 through 2001. For accident year 2001, the percentage market share for these coverages ranged between 78% and 95% for the other Atlantic Provinces, the comparable rate for accident year 2001 in Newfoundland is 74%.

Mr. Kehoe offered some insight into this category of risk. He stated himself that there were some taxi operators working in the industry with whom he would not want his worst enemy to ride. Mr. Kehoe spoke of what appears to be a very relaxed attitude on the part of certain taxi brokers as to the driving records of their individual operators. He also spoke of taxi operators who suffered from medical conditions which he felt, should have prevented them from being on the road at all. He described in his own direct knowledge working for taxi brokers where he has never been asked to provide a driver's licence abstract, and the taxi broker does not know whether Mr. Kehoe has 15 convictions or no convictions. It is not therefore surprising that if this type of attitude is prevalent in the industry that this category of vehicle would have revealed itself as constituting a higher than normal risk.

FACILITY ASSOCIATION PROFITABILITY

During the course of the hearing, a good deal of evidence was presented dealing with the issue of Facility Association's profits over the period of time in which it has operated in this jurisdiction. There may well be differing views as to the implications for profitability based on the present legislation, and whether that legislation, properly interpreted prohibits member

companies from directing Facility Association to, from time to time, file for rates which include a profit component. The Board, in its decision on 30 March 2001, following the last Facility Association hearing ruled that Facility Association profits should not be used in setting rates for the future. In the present application, and in all applications which have been filed by Facility Association in Newfoundland, rates have been proposed on an intended breakeven basis. The revenue generated through the mechanism of Facility Association is therefore intended to cover the mechanism's operating expenses and the direct expenses attributable to member companies as a result of their compulsory membership. The results of Facility Association's operations, now in its 17th year, speak, we suggest, very highly of Facility Association's actuarial efforts, and of the degree of success of the Public Utilities Board in its rate setting efforts. As the latest financial information discloses, Facility Association will have generated an overall surplus of approximately 2 ½ % over the past 17 years of operation. Ignoring the time value of money, this would constitute a return of about one-seventh of one percent annually.

CONCLUSION

The Board has conducted a comprehensive hearing. It has heard from the applicant's Actuary, and the Board's independently retained Actuary. It has heard from the Chief Executive Officer of Facility Association and, on the motion of the Board, from Mr. Thomas Hickey, an Independent Broker, and Mr. David Anthony, the Chief Executive Officer, Insurance Corporation of Newfoundland, one of the four servicing carriers for Facility Association in Newfoundland. The Board has also heard from officials from the Department of Motor Vehicle Registration and from the Department of Highways, the acting Chairperson of the Seniors' Resource Centre Association of Newfoundland, Bruce Whiffen, a Meteorologist with Environment Canada and from Sargent John Hill, a member of the Royal Newfoundland Constabulary. While some of the evidence presented is, we submit, outside of the scope of the strict actuarial review, all the evidence has been helpful in presenting the very broadest picture to the Board as to the operations of Facility Association in this jurisdiction, and its interaction with brokers and agents, with servicing carriers, and with the public, and of course, its statutory and contractual relationship with member companies. We submit that the evidence has established that Facility Association is operated in a prudent and efficient manner in this jurisdiction, strictly following the statutorily prescribed Plan of Operation. At present, rates for

policies issued through the mechanism of Facility Association are seriously deficient and significant increases are required to achieve rate adequacy.

The increases necessary to bring about rate adequacy must, of necessity, we submit, be determined based upon actuarial evidence presented to the Board. The Board therefore must make a determination as to which actuarial expert has offered the more compelling evidence in those areas where it acknowledged the actuaries are in disagreement. It is the applicant's submission that Mr. Pelly has had longstanding experience with Facility Association in this jurisdiction and in others, and has presented a rate filing using sound methodologies and assumptions. He has, we submit, provided *viva voce* evidence in a comprehensive and thoughtful manner. It is respectively submitted that Mr. Pelly has thoroughly responded to each of the concerns raised by the Board and its Actuary in a manner which fully explains his thought process and his actuarial judgments, particularly in those areas where his opinions and those of Ms. Elliott, diverged. It is therefore respectfully requested that the rates as filed be approved, that Facility Association be authorized to implement the CLEAR system of automobile rating proposed in the application, and that the accident and conviction surcharge schedule and the clean driver discount also be approved as filed.

ALL RESPECTFULLY SUBMITTED this_____day of _____ 2003.

_____

Norman J. Whalen, Q.C.
Kevin F. Stamp, Q.C.

MARTIN WHALEN HENNEBURY STAMP
Solicitors for Facility Association
WHOSE ADDRESS FOR SERVICE IS:
15 Church Hill, P. O. Box 5910
St. John's, NL A1C 5X4