

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. A22;

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

**SUBMISSION OF COUNSEL
TO THE
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES**

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February 6, 2003

APPLICATION

This is an application by Facility Association for an increase in rates for Private Passenger and Commercial coverages. There may be secondary impacts as certain other rates are set by reference to these coverages. Also it should be noted that the changes to the Accident/Conviction Surcharge Schedule are proposed to apply to all classes of vehicles.

STATUTORY FRAMEWORK

The Public Utilities Board has the authority to hear and decide on this application mainly under the provisions of three pieces of legislation- The *Automobile Insurance Act*, R.S.N. 1990, c. A-22; The *Insurance Companies Act*, R.S.N.1990, c. I-10 and the *Public Utilities Act*, R.S.N. 1990, c. P-47. The *Automobile Insurance Act* sets out the authority of the Board with respect to the setting of rates for insurers in general. The *Insurance Companies Act* establishes/continues the Facility Association and gives rate setting authority with respect to the Facility Association to the Board. The *Public Utilities Act* sets out the general authority of the Board with respect to practices and procedures. The most relevant provisions of this legislation are set out below.

Automobile Insurance Act

48. *The board has the general supervision of the rates an insurer charges or proposes to charge for automobile insurance.*
49. (1)*An insurer shall annually file with the board the rates it proposes to charge for automobile insurance.*
(2) *The board shall, within 60 days from the filing of the rates, approve, prohibit or vary the rates filed under subsection (1).*
50. *An insurer shall not charge rates that have not been approved or considered to have been approved by the board under this Act.*
51. *Where an insurer wishes to make a change with respect to the rates approved under this Act, the insurer may make an application to the board for the approval of the change and the board by order may approve, prohibit or vary the change.*

Insurance Companies Act

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) 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.

Upon reviewing the legislation it is apparent that the statutory provisions, or the regulations thereunder do not set out specific requirements, principles or guidelines to be followed by the Board when determining the rates. Historically the Board has established rates based upon the actuarially justified loss costs. That is the rate is established after an actuarial analysis of the amount required to pay all expenses given the predicted loss costs for the relevant period.

ISSUES

Rate Determination and the Role of Policy Issues

It was clear throughout this matter that Facility Association is seeking rates based upon the actuarially justified loss costs, consistent with the historical rate setting methods. However several policy issues were raised throughout this application which may be relevant to the rate setting process, including:

- The objective of Facility Association to reduce its market share.
- The consistency of rate structures for both Private Passenger and Commercial coverages.
- The consistency of rate structures between the voluntary market and the Facility Association market.
- Elimination of competition between the voluntary and the Facility Association market.
- The viability of Grey market insurers.
- Behaviour modification structures.
- Rate impacts upon consumers.

It is apparent that some of these general considerations are reflected in the rate proposals whereas others merely form the backdrop to this application. The Board when setting the rates may not explicitly address each of these general issues but may wish to rationalize these considerations as a part of its decision making process. Some of the specific ways in which these policy issues were reflected in the Facility Association proposals include:

- a. In the case of underage drivers, the cap on changes in class differentials was increased from 5% to 7.5% to avoid potential competition between the voluntary market and the Facility Association market.
- b. The Accident/Conviction Surcharge schedule was amended to keep rates appropriately above the voluntary market, to ensure consistency across jurisdictions and to provide a disincentive to drivers who are exhibiting poor driving habits.
- c. A Conviction/Accident Free Discount was introduced to encourage and reward good driving behaviour.
- d. The All Perils premium for both Private Passenger and Commercial was changed to ensure that the rate structures are internally consistent. With this change the similar coverage will have the same rates.
- e. The differentials for Commercial Specified Perils were changed to match the Comprehensive rate group differentials to ensure that rate structures are internally consistent. This change will ensure that rates for the more limited Specified Perils coverage will be less than the Comprehensive coverage.
- f. Minimum deductibles for commercial are increased to \$500 for collision and \$100 for comprehensive, to ensure that rate structures are internally consistent.
- g. CLEAR is proposed to be implemented which will ensure consistency with the voluntary market.
- h. Specified Perils rates are set by reference to the proposed Comprehensive base premium again for internal rate consistency.

Reconciling the Expert Opinions

The fundamental challenge for the Board in prospective rate setting is to reach a decision which ultimately reflects the future. In making this determination the Board has the benefit of hearing from actuarial experts, who provide their opinions as to the reasonable expectation for the future

based upon an analysis of past events. Given that this evidence amounts to a prediction for the future it is likely that neither of these experts will be “precisely correct”. It is an exercise in judgment for these experts and ultimately for the Board.

Actuarial Judgment

We saw during the hearing that judgment pervades actuarial opinions. Throughout the formulation of actuarially justified rates there are judgments that must be made, the accuracy of which will not be known until the future. The starting point of the actuarial analysis is the reserves which are the estimates of the ultimate claim costs set by the adjusters. These reserves are made up of amounts already paid plus further amounts that the adjuster predicts will ultimately be paid out with respect to a particular claim. We heard testimony that for various reasons these reserves typically prove to be inadequate. To reflect these inaccuracies and to account for the fact that many claims are not reported on time, loss development factors are applied to the reserves. The loss development factors can be significant, possibly doubling the reported incurred losses in the case of bodily injury.

After the application of loss development factors, trend factors are applied to the total predicted loss costs. Trend factors are used as a means of adjusting historical data to make it relevant in a future rating period. The actuary will use trends to build an understanding of the long-term patterns of change. Like the loss development factors, the trend factors can be significant and in the case of private passenger bodily injury is in the order of 20%.

Given the amount of judgment that is involved in the actuarial analysis it is not surprising that the opinions of the two experts presenting evidence were different. Set out below is a table which identifies the amount that the rate increase sought by Facility Association would be reduced by the use of the approach of Mercer Financial.

Private Passenger

Proposed Rates	16.9%
Loss Development	12%
Trend	3%
UALE Provision	1%
Separate BI and PD	1%

Commercial

Proposed Rates	17.6%
Loss Development	2%
Trend	15%
ULEA provision	.5%

Private Passenger

In terms of Private Passenger coverage by far the most significant difference between the experts relates to the way in which the loss development factors were calculated. Rate indications would be reduced by about 12% if the loss development factors suggested by Mercer were used.

While both experts agree that there must be a balance between stability and responsiveness, the specific approach taken by the experts within these broad principles vary greatly. The most significant difference between the experts is the exclusion of data points by Facility Association in determining the loss development factors. The Facility Association rate proposals are calculated excluding several data points which in each case were the lowest data points in the grouping. Facility Association viewed these points to be outliers as it was felt that they were not representative of the future. As Mercer did not exclude any points in determining its loss development factors its rate indications were substantially lower.

Commercial

The comments above with respect to loss development apply in the commercial context except that the impacts are much smaller, amounting only to a 2% difference. The method of calculating trend factors has the most significant impact on the commercial coverage, amounting to about 15%.

IMPLEMENTATION**Timing**

The proposed implementation date, of February 1, 2003 is no longer realizable and it is clear that Facility Association will need a period of time after the order to implement the rates. It is apparent from the evidence that Facility Association would require a period of at least 105 days and where the proposals are significantly changed more time will be necessary.

Specific Issues

Implementation of rates is complex and there are many facets of each element of the rates which should be considered by the Board during its decision making process, including:

- **Trend Factors** - The trend factors reflect the long-term patterns of change based on the proposed implementation date of February 1, 2003. Since the rates will not be put in place until some months later, it follows that trend factors for these additional months will not be reflected unless specific provision is made.
- **Accident/Conviction and Surcharge Schedule and Accident/Conviction Free Discount** - The introduction of the changes to the schedule and the discount are intended to be revenue neutral. A change to one item without a corresponding change to the other may frustrate this intention.
- **Separate analysis of Bodily Injury and Property Damage** - The Facility Association actuary acknowledged that Mercer Financial's suggestion to separate the analysis of bodily injury and property damage deserves further study. If the Board is ordering changes in any event there may be an opportunity to either implement this change or to require Facility Association to report later to the Board on this approach.
- **Updated Information** - If the Board does change the proposals of Facility Association, it may be an opportunity to update the proposal to reflect the more recent AIX data.

Process

The Board has four basic options in terms of the process it may adopt in reference to the implementation of the order.

- 1) The Board could on the basis of the evidence heard in the hearing accept the filing of Facility Association, implement the rate changes as set out in the Eckler report and approve the rates as filed.
- 2) The Board may accept the recommendations of Mercer Financial and adopt the rate indications set out at page 19 and 26 of the Mercer Financial report. In this scenario the Board may issue an order which establishes the percentage rate change for each coverage. Based upon this order, Facility Association would be required to file new rating pages with the Board.

- 3) The Board may not accept either of the experts reports in their entirety. The Board may, based upon the evidence filed, adopt percentage rate changes which were not proposed by either actuary, and order Facility Association to re-file the rates based upon the percentages set out in the order.
- 3) The Board rather than setting out the percentage rate changes in its decision, may set out the principles on which the rates should be based. In this case, Facility Association may be required to submit new proposed rates based upon the principles set out by the Board. These revised rates would be reviewed by the Board to ensure that they are consistent with the Board order. This process would be one of regulatory compliance and would not involve consultation with the public or the consumer advocate. While this secondary process may result in a further delay to the implementation of the rates of about one month, this approach would allow for accurate calculation of the rate indications flowing from the decision of the Board.

Dated this 6th day of February 2003.

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Commissioners of Public Utilities