(9:05 a.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: Good morning ladies and gentlemen.

MR. STAMP, Q.C.: Good morning.

MR. O'FLAHERTY: Good morning.

MR. SAUNDERS, PRESIDING CHAIRMAN: We'll get the hearing going this morning, are there any preliminary matters before we resume with Mr. Pelly?

MS. NEWMAN: Mr. Chairman, I just wanted to advise the Board that Facility Association has circulated another, a colour copy of the document that was circulated yesterday which comprises the slides that Mr. Simpson *(sic)* is presenting.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MS. NEWMAN: I would propose that we call that DGP-3, or DJS, sorry, 3.

MR. O'FLAHERTY: DGP?

MS. NEWMAN: DGS, no sorry ... DGP ... I was right the first time, yeah.

EXHIBIT DGP-3 ENTERED

MR. SAUNDERS, PRESIDING CHAIRMAN: Anything else, Ms. Newman?

MS. NEWMAN: No, that's it.

MR. SAUNDERS, PRESIDING CHAIRMAN: So are there any other matters ...

MR. O'FLAHERTY: No matters, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: No matters? Mr. Stamp, Mr. Whalen?

MR. STAMP, Q.C.: Perhaps, Mr. Chairman, I could mention we've attempted to get some idea whether or not we can have service carriers and/or a broker available for the hearing. We've spoken to one of the service carrier officials and he seems to indicate that he would be available to come, he prefaces it on the limited basis that we sort of talked about, I guess, yesterday, and hopefully he understands what that basis is. We have not yet been able to reach a broker to speak with him about, to speak with one of the brokers about their availability to come and give evidence and we'll be trying to pursue that again right after this hearing concludes today, I guess, to try and see if we can find somebody to help us in that regard.

MR. SAUNDERS, PRESIDING CHAIRMAN: Well, if you need an extension of the time that we sort of set yesterday, that's understandable, but I guess the main point is that you are able to get someone to come along. The timing ... well, you want to get this over with as soon as you can ...

MR. STAMP, Q.C.: Yes, certainly.

MR. SAUNDERS, PRESIDING CHAIRMAN: And certainly I think everyone is in that mode. Alright, well then you can keep Ms. Newman advised as to what the situation is there, and we'll deal with it as we see fit.

MR. STAMP, Q.C.: Thank you.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, good morning, Mr. Pelly, are you ready to resume your direct examination?

MR. PELLY: I am, sir.

MR. SAUNDERS, PRESIDING CHAIRMAN: Good, so I'll let you go with Mr. Stamp then.

MR. STAMP, Q.C.: Thank you.

MR. PELLY: Just before I jump into that I'd like to make one, hopefully minor correction to my testimony yesterday. I was speaking of what was included and what was not included in the expense provision in the premium for Facility Association. I referred to the sales tax that was not included, and I believe at one point I referred to it as the HST. I have been corrected on that that it's not the harmonized sales tax, but it is sales tax.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes, I do recall you referring to that.

MR. PELLY: I also made reference to the linkage with the New Brunswick commercial uninsured automobile premium as the basis for the proposal that we've made in Newfoundland. I am seeking to determine what the approved commercial uninsured automobile premium in New Brunswick has been so that I can give that information to the Board as well, but my colleagues in upper Canada aren't awake yet, so ...

MR. SAUNDERS, PRESIDING CHAIRMAN: And that, I assume, has to do with the time of day more than anything else.

MR. PELLY: I believe so.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MR. STAMP, Q.C.: Now, Mr. Pelly, I think we left off yesterday, I think the next area that we would have gone to would have been, I guess, your reply, if you like, to the work that was done for the Board directly by Mercer's in their review of your filing, so if you can take us to, I guess, the first of those topics that you want to deal with this morning.

MR. PELLY: My intent is to walk my way through the report prepared by Mercer, and just for clarity of reference, that report was dated 26 November 2002, and entitled, "Facility Association Rate Filing Review, Newfoundland and Labrador, Board of Commissioners of Public Utilities", and it was cosigned by the two Board actuaries in the room today, and I'm not sure if it has a reference yet, but I refer to that as the Mercer report, is that sufficient?

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, I have it.

MR. PELLY: So I'm basically going to be offering some commentary on the observations expressed by, or in the Mercer report, just to build on what I have already provided in terms of general information with respect to the methodology and with respect to why we do the things that we do in our filing, in our application.

So in the Mercer report I'm basically jumping to page 9 of the report, which is the beginning of the findings section for private passenger vehicles, and in fact, I guess I'm jumping to page 10 which is where they begin with their first areas of comment on loss development factors.

(9:15 a.m.)

In total, as part of their undertaking, Mercer recast the indications using alternative assumptions that they found to be, in their opinion, more appropriate to the circumstance than those which I've used in the application. With respect to private passenger vehicles, their restated overall indicated change in rate level is plus 24.4 percent in contrast with the application's plus 41.3 percent, so it is still a significant indicated need for rate level based on the Mercer restatement, but the discrepancy or the difference of view in that regard is a difference of 16.9 percentage points, or if I can round that to about 17 percentage points, and I'll be making reference to that 17 point difference a couple of times.

So I'd like to start with respect to some of the observations made by Mercer on the selection of loss development factors. Mercer states that the use of a five year average as the basis for selecting loss development factors is reasonable, and as a basic approach, that is the basic approach that we use in our application.

MR. STAMP, Q.C.: Where is this stated, Mr. Pelly, in the report?

MR. PELLY: In our, in the application, or in the Mercer report?

MR. STAMP, Q.C.: Yes, the five year average is ...

MR. PELLY: That's on page 11 at the beginning of the third complete paragraph, or the fourth paragraph on that page, beginning, "We find the use of the five year average to be reasonable".

MR. STAMP, Q.C.: Alright.

MR. PELLY: One of the things you're trying to do when you're selecting loss development factors is decide on a balance between stability and responsiveness. That is something that you'll hear actuaries talk about all the time. Stability meaning looking to the longer term, looking to smooth out the rough, the ups and the downs in the experience period and attempting to take a bit of a longer term view. Responsiveness is in the opposite direction, and is taking the position of wanting to be more responsive to the latest experience, so actuaries in making assumptions and in choosing methodologies, need to strike some kind of a balance between responsiveness and stability.

In making the choice to use as a basis for a starting point selection of a loss development assumption, using a five year average is striking that balance at a level that we're saying we're going to at least look at the last five years of data before making a selection with respect to loss development, so one could choose the longer term average, one could use a shorter term average, and it appears that on that particular matter, Mercer is in agreement that five years is a reasonable historical period over which to choose an average.

The remainder of that sentence identifies the fact that with respect to bodily injury and later they also extend that concern to the accident benefits coverage, Mercer has concerns with respect to our choice to exclude certain data points from the averaging process in selecting loss development assumptions, and then at the beginning of the paragraph following, they make a recommendation that they would use a five year weighted average with no data points excluded as the basis, or as the rule for selecting loss development assumptions.

Based on Mercer's analysis, they attribute about 12 percentage points of the difference of opinion out of the total 17 that I referred to earlier, about 12 percentage points relate to this particular issue, so it's a very significant portion of the total difference of opinion, or to put it another way, with respect to private passenger vehicles, this is the, this is where we disagree the most.

When Mercer was reviewing the May 2001 application, that's the previous Facility Association application to this Board for a rate level change, that particular application primarily addressed private passenger vehicles, they reviewed the filing and in their report on that filing they indicated that they found the loss development factors to be reasonable as selected in the May 2001 application.

Now there were differences in the May 2001 application from this application, at least with respect to bodily injury ... differences in the fact that it was an updated analysis and it used mid-year data because it had become available by the time the filing was submitted, and we were seeking to take advantage of the mid-year data that was available.

The addition of that mid-year data did change the way or the basis upon which the database upon which the analysis of loss development was undertaken, and specifically we had to use accident half-year data in that analysis as opposed to the accident year data that we're using in the current analysis.

Having said that, in the previous filing, we did make use of, as a standard approach, a five year, or a ten accident half year average approach as our basis, our general basis, our general starting point for purposes of selecting loss development factors, and we also made data exclusions in the previous application.

Philosophically we were following the same general approach as we're following in this application, so for reasons that I can't explain, that approach was reasonable in the previous application and has now been found to be unreasonable.

Part of the process that we go through is identifying data points which we find, or we consider to be outliers for purposes of selecting a loss development assumption. An outlier, choosing an outlier, or identifying an outlier is a judgemental process, and we don't have at this time anyway, a statistically rigorous test for identifying an outlier in the selection of a loss development factor, and clearly there's room for differences of opinion in making judgements.

The purpose of identifying an outlier is to be consistent with the objective of rate making to build an expectation for the future. The purpose of making these assumptions for loss development factors and any of the other work that we're doing in rate making, is to choose assumptions that lead you towards developing an indication that is relevant in the future, or in the prospective sense, so you're trying to use the experience of the past to guide you to construct an expectation for the future.

So our view would be that if we find a data point is not characteristic of what we expect in a future period, then we would exclude it from the average in the selection of a loss development assumption. Now, I've got a series of two graphs which I'm going to put up on the screen, and I'll try and explain generally what it is that we have on the graphs and then talk a little bit about how that captures what we've done and Mercer's point of view as I best understand it.

The left-hand side of this exhibit, or the scale on the left-hand side of this exhibit is labelled "loss development factors", and these are the, or this is the scale that captures the actual numbers that we're looking at, these are the, either the historical values or the selected values that we are using for purposes of making loss development assumptions.

As you get out to the right-hand side of the scale, these will gravitate towards a value of one, so if you look at the red line for the moment, you can see that it starts at a value greater than one and moves towards a value of one as we go to the right-hand side of the screen.

MR. STAMP, Q.C.: Mr. Pelly, just before you go into that any further, can you identify in the package we have which is the document? I think I've located it, unfortunately these are not numbered.

MR. PELLY: Yeah, I regret that, but it's ... the, it's the page immediately following the one that's labelled "CLEAR dislocation".

MR. STAMP, Q.C.: It's the twelfth page, I believe, in the package, Mr. Chairman, and for the benefits of others.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes, the twelfth.

MR. PELLY: My apologies for forgetting to get them numbered. The scale on the bottom of the graph are the successive development intervals, so in the case of accident year data, the first development interval is going from 12 months to 24 months, from one year to two years of age. The second development interval is from 24 months to 36 months, etcetera. Over each development interval there are a series of data points plotted on the screen. There are yellow data points, blue data points, black data points sometimes, and red data points, and for purposes of presentation in this exhibit, the red data points have been connected with a line.

There is a legend at the bottom of the page, but I'll just try and explain what all of these different colours represent. The yellow triangles represent actual historical loss development factors from the history for portions of the history that are more than five years old, so that's the older historical data, if you can characterize it that way.

The blue data points represent the actual historical loss development assumption or factors, sorry, that are within the last five years. The black data points, when they appear, are actual historical development factors within the last five years that were excluded from the average that we selected, so the blue, there will either be ... you may not always be able to see them all because sometimes they stand on top of each other, but there will either be five blue dots, or the total of the number of blue dots and black dots will be five, because they both come from the latest five year average, five years of history. And finally, the red dot is the selected value that we made.

Our objective in going through this process is to choose, put the red dot where we think the history, the recent history, is telling us is a reasonable expectation for the future, so when we see a black dot, it means that we excluded that point from the average because we didn't characterize that value as being representative.

The first black dot, moving from left to right on this exhibit, appears in development interval two, that's the 24 to 36 month interval. It's the lowest value in the column, it's substantially below any of the other blue dots which represents the latest history, and we did not consider that data point to be representative of our expectation for the future. I mean literally the word "outlier" means just what the word sounds like, it didn't look like the other data points. It did have, in the more distant past, it did have some history, some historical values that were in that vicinity, but that was not the recent historical pattern and our objective here is to use the history of the past to build an expectation for the future.

MR. STAMP, Q.C.: So the yellow dots that are identified in that particular column, number two, were they data points which were included in selecting the red line?

MR. PELLY: No.

MR. STAMP, Q.C.: They didn't fall within that ...

MR. PELLY: No, the selection focus is on the five latest data points, which will either be blue or black.

MR. STAMP, Q.C.: So to show, what's the purpose of showing the yellow dots, Mr. Pelly, when they don't form part of the analysis, I guess, for the creation of the red line?

MR. PELLY: The purpose of showing the yellow dots is to show the historical range that has existed, so I don't dispute that there are yellow dots in the vicinity of the excluded black dot, but the issue is whether or not that level of development factor of just over .9 for that black dot that was excluded in the second development interval, whether or not that represents a reasonable expectation for the future. Is it in the neighbourhood of the recent history, and is that an appropriate guide to making a selection for a future development interval.

(9:30 a.m.)

MR. STAMP, Q.C.: And when you study the Mercer report, which is a review of your work, what did they say in terms of this line number two, about the use of the yellow dot data?

MR. PELLY: They are in agreement that the five year history is the appropriate period of time over which to make a factor selection, but their position is that we shouldn't be excluding the black dot, we should be including consideration of the black dot value in with the other blue dot values for purposes of selecting the red dot.

MR. STAMP, Q.C.: Do they want to include the yellow values?

MR. PELLY: No, they're happy with the five year historical perspective. For the benefit of not trivializing the actuarial profession, we don't really use dots. I'm attempting to make this pictorially pleasing.

MR. STAMP, Q.C.: So the point you're making, Mr. Pelly, I guess, is that the blue dots are fairly tight to the line at that point.

MR. PELLY: Yes, I mean that's going to be a natural consequence of choosing the red dot as an average of the blue dots that remain, that remain as part of the underlying average.

MR. STAMP, Q.C.: So what would happen if you, in this particular occasion, just in a general way, what would happen to the line if you included the black data point in your material to help you decide where the average should be?

MR. PELLY: Well, the value, the red value would pull down. It would be, it would be pulled down by the additional consideration of the black value, so instead of ... the red value, it's at a value of 1.191, and if we changed it to include the black value and changed to use a weighted average instead of a straight average, the selection would be ... well the selection actually goes up in this instance, but that's because of the change to using a weighted average, which is a different issue.

MR. STAMP, Q.C.: But not using the weighted average?

MR. PELLY: I'd have to get the filing out, one second. I'm sorry, I was looking in the wrong development interval when I just spoke. We selected a factor of 1.161.

MR. SAUNDERS, PRESIDING CHAIRMAN: Instead of 191?

MR. PELLY: Yes, in this development interval. If ...

MR. STAMP, Q.C.: That's where the red dot is.

MR. PELLY: That's where the red dot is in development interval two. If we had picked a five year average without doing the data point exclusion, it would have been a value of 1.111, and by moving to a weighted average instead of a straight average, the value falls to 1.106 in this instance.

Now, I don't intend to talk about each of the black dots and each of the red dots. I am happy to address any particular ones that I've come to be cross-examined on. I'm providing the information here in a pictorial form because you'll see a very similar pattern as we go through these, as you go across the page, and any time you see black dots, we characterize those black dots as not being representative of the recent historical pattern, and we're seeking to build an expectation for the future. We choose judgementally not to have that expectation distorted by values which we characterize as not being representative of our expectation for the future.

MR. STAMP, Q.C.: And so how many places on this particular chart were data points excluded?

MR. PELLY: It appears that there are a total of five data points excluded.

MR. STAMP, Q.C.: So that number three has two black ...

MR. PELLY: Yeah, there are two values which means only three remained in the average that was selected, and in fact it's the three latest values that were selected. They're tightly clustered, as you can see there's ... well you can't see that there's three blue dots, but there are three blue dots behind the red one. They're tightly clustered, they represent the latest three values and it's a verifiable fact that the general claims environment in Newfoundland and Labrador, as well as other Atlantic jurisdictions, has become harsher, it has become a more aggressive claims environment, and development has become more pronounced on this kind of a line of business.

MR. STAMP, Q.C.: And Mr. Pelly, just to take another example then, just one further example, in, I guess, point number five, we don't have any black dot, therefore there's no excluded value, I presume.

MR. PELLY: That's correct.

MR. STAMP, Q.C.: It's difficult to see five blue values but they are there, are they?

MR. PELLY: They are there and they're either hidden by the red dot or hidden by another blue dot, they're all very tightly focused. Just taking a quick look at the next, the next page, this is the same kind of information, but instead of being for bodily injury, it's for accident benefits.

MR. SAUNDERS, PRESIDING CHAIRMAN: Can we call that 13, Mr. Pelly, the next page, I mean.

MR. PELLY: Yes.

MR. SAUNDERS, PRESIDING CHAIRMAN: Just for identification for later on.

MR. PELLY: I appreciate you keeping me on track.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MR. PELLY: There are data points excluded on here in two of the intervals ... in the second development interval and in the fifth development interval. The fifth is a bit of a non-issue because inclusion or exclusion of that data point has very little bearing on the selected red value, but we still chose to exclude the data point because it was a little bit lower than an earlier history point.

The second development interval, we have the same basic pattern as I described on the previous page. It still falls at the bottom of the historical, the long-term historical levels, and clearly is not in the same neighbourhood as the more recent historical levels.

MR. STAMP, Q.C.: Mr. Pelly, how does this actually work? I mean I presume you don't draw this type of graph, chart, and then say, well I think that the black spot is too low here and I'll take it out. How do you actually do that?

MR. PELLY: The exhibits that are provided in the rate filing demonstrate our work, the results of our work, but basically when we're doing our work, we're working with exhibits as they are presented in the filing.

MR. STAMP, Q.C.: Numerical data.

MR. PELLY: Numerical data, the historical values are presented in a triangle, loss development triangle, and we study the recent historical data, the older historical data, whatever we know about the claims environment or unusual events that have occurred and give consideration to all of those things for purposes of making development factor selections, so ... and in addition, we're considering the development factors that we've selected the previous occasion, so that we can be guided by how our view is changing. There's a lot of thought that goes into the selection process because you're seeking to, as I keep on saying, you're seeking to make a selection that is consistent with your expectation for the future based on your analysis of the recent past.

MR. STAMP, Q.C.: So the filing in May 2001, you followed the same sort of process?

MR. PELLY: Very similar. It would have been based on accident half year data instead of accident year data, but fundamentally, the same process.

MR. STAMP, Q.C.: And when you went through that data in the May 2001 filing, you also judgementally determined that there were data points that did not fit the proper pattern.

MR. PELLY: Similar data point exclusions were made.

MR. STAMP, Q.C.: Alright, and that's the filing that you say with respect to which Mercer's did not disagree with you?

MR. PELLY: On that occasion, that's correct.

MR. STAMP, Q.C.: On that particular point.

MR. PELLY: Now, the other sort of different focus that Mercer's had on this particular issue was the choice to use a weighted average instead of an average, and in this particular instance ...

MR. STAMP, Q.C.: That's the next paragraph you read from a few minutes ago, I take it?

MR. PELLY: That's correct.

MR. STAMP, Q.C.: Yeah.

MR. PELLY: In this particular instance the choice of a weighted average versus a straight average is the less important issue compared to the decision to exclude data points or not exclude data points, so of the twelve points in overall rate level difference of opinion, I can't actually separate the two between the ... not without doing a fair bit of work, between the two issues that we disagree on in this subheading, but I can tell you that the majority of the difference of opinion is driven by the decision, our decision to exclude data points. The issue of weighted average versus straight average is not a major issue in this particular instance. But on that issue, there is one thing that I want to mention. The process of using a weighted average basically gives recognition to whatever historical period you're using for purposes of averaging, and treating it as if it's a single development point by taking the total incurred losses for the five years, if you're pulling five years in at the end of the period, at 24 months of development, say, and then taking the total incurred losses, reported incurred losses at the beginning of the development interval for the five years and taking the ratio of the two. That's what a weighted average is in this sense ... as compared to taking each of the five individual loss development factors and averaging them.

Facility Association in the five years that are encompassed within the history that we have here has gone through a period of declining volume in the late recent development, or recent accident years. One of the consequences of using a weighted average in a period of declining volume is that naturally more weight will be accorded to the period when there are more losses, and there are typically more losses when you have greater volume, just in terms of dollars. If you have more vehicles exposed, there's going to be more losses exposed, that's the general expectation, so the decision to move to a weighted average in an environment where you have a declining volume is a decision to move less emphasis onto the latest experience, and more emphasis onto the old experience. The danger of doing that in this particular environment, today's claims environment, is that you're choosing to put less emphasis on the more harsh claims environment that we're experiencing in the insurance industry today. That's a ... it doesn't make it right or wrong, but it's a decision in striking that balance between responsiveness and stability. We chose averages instead of weighted averages.

MR. STAMP, Q.C.: Mr. Pelly, just to go back for a moment to the May 2001 filing, did you use a weighted or non-weighted average on that occasion?

MR. PELLY: There may have been coverages for which we used weighted averages, but for the bodily injury and accident benefits coverages, we used averages.

MR. STAMP, Q.C.: So the comparable work on this topic in the previous filing was done the same way?

MR. PELLY: Allowing for the accident half year distinction, yes.

MR. STAMP, Q.C.: Did Mercer's in respect to that approach have any disagreement last time?

MR. PELLY: No. On page 12 of the Mercer report there's a table provided, and it was actually amended or there was a minor presentation error in the table as originally provided, and it was amended in response to question FA-1.0.

MR. STAMP, Q.C.: Are you going to the three charts now, Mr. Pelly?

MR. PELLY: There's three tables presented as to augment the text provided in response to question FA-1.0. Now, the purpose of our asking question FA-1.0 was to understand why the table was in the report in the first place, in the Mercer report, and in their response, Mercer indicated that it was ...

MR. O'FLAHERTY: Excuse me, Mr. Chairman, I'm still trying to find the document. Sorry, I don't mean to interrupt you, Mr. Pelly. Thank you, I have it.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, fine, thank you, Mr. O'Flaherty, okay, Mr. Pelly.

MR. PELLY: In their response to our question as to why the information was provided, Mercer's indicates that they're just making the observation and the observation they're making is that in the December 1997 filing, that's two filings ago, compared to the current filing, the earlier filing appears to have over-estimated Facility Association's expected ultimate cost of claims compared to the current filing. So the current filing uses more mature data and the current understanding of the expected ultimate cost of claims is lower than it was in the 1997 filing, but they're not drawing any conclusions, they're not ... it's not clear why it's been included into the report.

I want to make comment on this because this was a topic of some discussion at the previous Facility Association hearing. In general, the Board's expert witness on that occasion did do a review of previous filings, actually filings previous to the December 1997 application, and made the observation that there had been favourable run-off, and that's what this particular report is referencing as well, and came to the conclusion that while there's been favourable run-off, and while current estimates of the ultimate cost of claims are lower than for this particular line of business, are lower than they were previously being held at. The estimates in the previous filings were reasonable based on the experience available at the time, and that there was no evidence of systemic bias in the selection of the ultimates in the previous filings.

Philosophically we're following the same general approach now as we were then, and I don't, we're revisiting material that was dealt with in the previous hearing. It's a historical fact that there has been generally, both for the industry and for Facility Association, favourable run-off over the period of time that elapsed between the previous, the data underlying the two previous filings.

MR. STAMP, Q.C.: And that's for those particular accident years, I take it.

MR. PELLY: For these five particular accident years. Although, I mean they were the most recent accident years that were available in the December 1997 filing, and there's no disputing the fact that there's been favourable run-off for Facility Association, for the industry as a whole, from the 1996 AIX to subsequent, you know, current versions of the AIX, so it's difficult to understand why that information is being presented.

(9:45 a.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: I wonder, Mr. Stamp, if Mr. Pelly could give us the reference that he was referring to the report back at the last FA hearing. Was that a specific reference, were you quoting or were you recalling from memory?

MR. PELLY: Well, I was recalling it from memory.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MR. PELLY: But I did read it prior ... I don't actually have that with me.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, no, I wondered if you were quoting.

MR. STAMP, Q.C.: It's actually, Mr. Chairman, I think for the record, it's actually contained in the Milliman and Robertson report that was filed at that time for that particular hearing, and I think Mr. Suchar also gave evidence through the course of the hearing that touched on this point as well.

MR. SAUNDERS, PRESIDING CHAIRMAN: Thank you, sorry for the interruption. Carry on.

MR. PELLY: The second part of our request in the FA-1.0 question was to ask that the same kind of a comparative presentation be constructed between the previous filing, instead of the second previous filing, between the previous filing and the current filing, so compare the May 2001 to the current application and just construct the comparable information, and that was presented. That's the table that is attached to, in support of FA-1.0.

There are actually two tables attached because in the previous application for the bodily injury coverage, there are actually two sets of estimated ultimate incurred losses; one initially based on the 1999 AIX, and then one that was updated using accident half year data reported up to June 30th, 2000, and so they kindly presented both estimates and the comparison of both estimates.

One observation you can make when you're comparing those two is that the evidence of favourable development, or sorry, favourable development that was evident from the top part of this exhibit, between the December '97 filing and the current application, most of that has disappeared when you compare the last previous application and the current application. In fact, in most instances we have slightly negative values appearing, so it is an established observation, both from the previous application and the industry generally, that there was favourable run-off over a period of time following after the 1996 AIX, but most of that favourable run-off has ended and we are now in a period of time when there is generally adverse run-off.

I'm not at a point where I'm going to be moving on to the next topic of discussion in the Mercer report, and this is on the subject of loss trends. Now, in loss development I said that the issues represented about twelve points of the seventeen points of difference of view. Mercer's has estimated that on the loss trend issue this is worth about three points of the seventeen points, so this is the second most important area for private passenger vehicles.

MR. STAMP, Q.C.: Yes, Mr. Pelly, that's the point I want to make, that this discussion that you've just been engaged in with respect to loss development factors, and the one that you're now about to go to, is with respect to private passenger, not commercial.

MR. PELLY: That's correct, strictly private passenger at this time. I'm just following the order of presentation in the Mercer Report for ease of reference.

MR. STAMP, Q.C.: Do you have any idea of the magnitude of, approximate magnitude of the volume of business for Facility that is private passenger as compared with commercial?

MR. PELLY: In the filing there is a value calculated for the estimated unlevel annual premium volume. On level means adjusting the latest accident years written premium to reflect the current approved rate level. It's an estimate but it's indicative of the relative orders of magnitude. For private passenger vehicles the Facility Association on level written premium in 2001 accident year was $11.4 million for private passenger and $623,000 for commercial, so in relative orders of magnitude, private passenger is significantly dominant.

MR. STAMP, Q.C.: Okay. $11.4 million versus $623,000.

MR. PELLY: In round terms. Mercer's in discussing loss trend identifies four issues in the approach that we've used for analysing trends with which they take issue, and I'll deal with each of those. The first one is that they are recommending the use of accident half year data for purposes of analysing trend. Their preference is to use regression models using accident half year data points and a history of accident half year data points rather than the approach that we use, which is using accident year data points or have used in this application, and they argue that the use of accident half year data adds precision to the trend analysis, and I'm quoting from the bottom of page 13 of their report where they say, "We believe that the consideration of accident half year experience adds a degree of precision to the trend analysis." I would offer the viewpoint that that's not necessarily so. For one thing, when you use accident half year data, it becomes necessary to incorporate into your trend analysis an added feature, an extra dimension to what you have to capture in the regression model, and that feature is the seasonality of the data. For many coverages there is a definite seesaw pattern in the successive accident half year history that reflects the fact that claims experience in the first half of the year is different than, typically, than claims experience in the second half of the year, and so if you're using accident half year data, you have to complicate, you have to make your regression model more sophisticated. You have another thing you have to estimate in order to be able to capture that seasonality. Now, that's not an insurmountable problem. It's just something else that you have to deal with, it's another thing that you need to estimate, and to represent that including another estimate improves precision I think is a bit of an oversimplification. But the other point that really worries me about using accident half year data in a jurisdiction like Newfoundland and Labrador kind of gets to the heart of credibility or reliability of the data. If you have an accident year statistic for Newfoundland and Labrador, you will instinctively attach a certain level of comfort with that statistic. You have a certain amount of faith as to how representative that particular data point is of a normal data point for that particular point in time, and if you take that data point and break it into two data points, one for the first part of the year and one for the second part of the year, logically you can't attach as high a level of comfort to each of those half data points. They become less certain, less stable. More inherent variability or potential for variability may exist in a half year data point than is true in an accident year full year data point. So when you're doing a regression analysis in a jurisdiction like Newfoundland and Labrador, for purposes of using accident half year data, there's going to be more noise in accident half year data, noise meaning just distortion, random, randomness in the way the experience unfolds. Then it's going to be the case in accident year data.

I do use accident half year data for trending purposes in some other jurisdictions, particularly Ontario, and Mercer's would have awareness of that because they also do regulatory review work in that province, and I'm comfortable using accident half year data in Ontario because of the sheer size of the insured fleet in Ontario. We have a much bigger population base in Ontario and the consequence of that is that although there is a reduced level of comfort with each of the accident half year data points, it's still at a pretty high level. It's just sort of the law of large numbers in layman's terms.

MR. STAMP, Q.C.: How would you compare, Mr. Pelly, the amount of data in an Ontario half year package, if you want to call it that, with a Newfoundland whole year? Is there any order of magnitude you can comment on?

MR. PELLY: I don't have any Ontario data with me. I'm not sure that I can rhyme that off the top of my head with any certainty, but population statistics are probably generally available somewhere. I'm sure I can dig something up. There's a substantially bigger population concentration and therefore driving population concentration in Ontario than there is in Newfoundland and Labrador. If anybody wants to dispute that with me, then I'm happy to ... I don't have a number off the top of my head, Mr. Stamp, I'm sorry.

The second issue that Mercer discusses in their report on trending for private passenger vehicles is the number of years that is pulled into the analysis. In the last paragraph on page 14 of the report they state, and I quote, "We believe 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, particularly for coverages involving vehicle damage." Once again we come to this point of taking a balance between responsiveness and stability.

MR. STAMP, Q.C.: And what does this indicate that they wish to do?

MR. PELLY: Well, by placing less consideration on the experience of older years they're moving you towards taking a more responsive posture in the trend selection process, and that's certainly a point of view that can be appropriate under certain circumstances, particularly in circumstances where you can see an evidence of a pattern shift in the historical data, and some of the charts, some of the graphs that I provided yesterday showed that evidence. There were frequency graphs, you may recall, where in the early years there was an upward direction in movement and then in the early '90s or late '80s it shifted. It just ... it peaked and started declining and declined for a period of ten years or so and then flattened out. Unless you can find a regression model that responds to the changes in direction of that pattern, it's appropriate to limit yourself to using periods of time for trending purposes that exhibit a similar pattern, because you may not be able to get a regression model to capture all of the ups and downs in the history, so there can be circumstances under which this is a very reasonable position to take. And their recommendation varies by coverage, which is much like our own approach. We vary the number of years we use by coverage, but their general position is that we've taken too long a view for purposes of making trend selection. Now, my philosophy in making trend selections is that I am looking for a long-term view.

(10:00 a.m.)

I am looking to identify the forces that are driving the cost of claims, loss costs primarily, or if I'm looking at frequencies and severity separately, then frequencies and severities. I'm looking to use the experience of the past to create for me an expectation about how year over year changes are expected to unfold going forward, and if all I did was take a look at the data point from two years ago and the data point from, the most recent data point, and take the ratio of those two and say, okay, that's my trend, that would be a very responsive position to take. Mercer's is not recommending that, by the way, but that would be the ultimate in responsiveness. We've got two data points, they change by "X" percent, so therefore going into the future that's going to change by "X" percent. No actuary is going to tell you that's a reasonable perspective and that would be because that's not really, there's too much randomness in the data. You're not necessarily going to get a reliable measure of how the forces are acting to cause trend, so you need to take a longer-term view than just two years, and how many more years you need is a matter of judgement. One of the things we do when we're making our regression model selections is we look at the statistics about how rigorously, how strong a regression, how much predictive power does the regression model capture, how well does it fit the data, and I have a series of graphs ... I'm going to spend a little bit of time on the first one explaining what I'm showing here and then I'll go through the other ones more quickly. A series of charts that summarize the recommendation being made by Mercer in their report and the trend selections that we made in the Facility Association rate application.

MR. STAMP, Q.C.: This is page 14, I think, in that package.

MR. PELLY: This would be the next page, yes, 14.

MR. SAUNDERS, PRESIDING CHAIRMAN: Maybe we could just number the next few pages then so that we'd be all talking about the same number, starting with page 14.

MR. STAMP, Q.C.: Yes, sir.

MR. SAUNDERS, PRESIDING CHAIRMAN: It makes it much easier at the end of this process when we're trying to put together the decision, Mr. Stamp.

MR. PELLY: I apologize for not thinking to put page numbers on. It was done in haste. So just first of all just introducing this chart and this table and what I'm trying to present in the table.

MR. SAUNDERS, PRESIDING CHAIRMAN: Carry on.

MR. PELLY: The first two rows in the table reflect the fitted annual trend that comes out of the selected regression model and one refers to it as past and one refers to it as future. In our work, we do make, on occasion we do make a distinction between past and future. Past takes us up to the most recent data point in the available history and future goes beyond that. So these are the annual rate of change in, in this case loss costs, that falls out of the regression model or that was assumed in the rate application. The next two rows are labelled R squared, and R bar squared. R squared is, in statistical terms is called the coefficient of determination. It's a percentage that falls somewhere between zero and 100 inclusive, and it represents the percentage of the total amount of variation in the data that is explained by the selected regression model, explained in the sense that the regression model fits the data in such a manner that it captures the movement, the variation in the historical data as you go from earlier data points to the later data points. So the higher the value is or the closer the value is to 100 percent, the more rigorous the regression model is considered to be, the better it fits the data. Now, R squared, the coefficient of determination, is not necessarily the be all and end all for the basis for identifying a better regression model versus a poorer regression model, and there are ways of being able to refine that number, and that gives rise to the R bar squared which is an adjusted coefficient of determination. It is adjusted to capture the fact that you can complicate a regression model by adding other variables to it, and an example is adding the seasonality consideration when you're using accident half year data, and in fact you can keep on adding regression variables until you get a perfect fit. You can get 100 percent as a coefficient of determination and it exactly passes through every data point in the history but is it intuitive and does it actually capture something meaningful is the question. In the R bar squared is an adjustment, there's an adjustment using a fit another fit statistic, that diminishes the R squared value if you have over-complicated the model by adding additional regression variables. So typically the R bar squared will be lower than the R squared and the amount by which it is lowered depends upon how much more complicated you've made the regression model, because arbitrarily you can make a regression model so complicated that it explains 100 percent of the variation but it's not really a meaningful regression.

MR. STAMP, Q.C.: Mr. Pelly, is this R squared and R bar squared study exclusive to your firm?

MR. PELLY: These are standard statistical tests for doing regression. They're not ... there's nothing magical here. They're well published tests, and in fact the R squared statistic in the statistics that we see below the T statistics are represented on the Mercer Report analysis. It doesn't actually appear in the Mercer Report but on the exhibits that were provided in response to FA 2.0 and 4.0, there are trend exhibits from the Mercer analysis and these statistics appear on those exhibits as well, not the R bar squared but the R squared and the T statistics do, so these are commonly used.

The last block of information deals with the variables that are being used in the regression and most of these tables that we're going to be seeing here have three, some of them have four, and I'll talk about that when we get to the first one. The regression is trying to find a formula that captures the pattern of change in the underlying data, and the formula is of a form where there is a constant, just a number, it's part of the formula, and then there's a variable that varies with time and there's a variable that varies with seasonality in this instance. The T statistic is testing the statistical significance of each of those variables as a contributor to the regression and its intent is to identify the extent to which that variable is meaningful to the overall regression. You have to pick a confidence level to test or to use the T test as a basis for determining whether a particular regression variable is meaningful or not meaningful. In our work we usually use a T test at a 99 percent confidence level, so in theory that's suggesting that you are, if it passes the test you've got a 99 percent confidence level that it is a meaningful contributor to the regression. For purposes of this slide I've used a 95 percent test. I'm not actually sure what test level Mercer uses because it's not disclosed on their exhibits, but anything much less than 95 percent in my experience, from what I've seen in reviewing other filings, is probably not commonly adopted. 95 percent is probably as low as I'd want to go in terms of using a T test.

In the T statistic for each of the regression variables, the constant, the time and the seasonality variable, what you are looking to have it pass is to be greater than the T test at 95 percent that appears at the bottom of the page. Now, the T test value needs to be selected off of a table that's dependent upon how many data points you are fitting the regression to and how many variables you are using in your regression model, so it's sensitive to the history and how complex a model you're using.

So now I'll turn my attention to what, this particular actual exhibit, which happens to be for private passenger bodily injury loss costs as it's labelled at the top. You can see that our trend model and the Mercer trend model produce pretty similar answers. Our answer is at 7 1/2 percent per annum and Mercer is at 7.1 percent per annum, so they're fairly close. I would submit that our model is a modestly better fit to the data that we've chosen for historical curve fitting purposes. We don't necessarily choose the same history in our two regressions, and that's based on the comparison of the R squareds or the R bar squareds. We don't use a seasonality statistic because we're using accident year data and we don't need to. All of our regression variables pass the T test at 95 percent confidence level. Their seasonality statistic doesn't and it fails it by a considerable margin, so there's some question in my mind as to whether or not their regression model is actually capturing seasonality or whether there is noise in what they're building into their forecast by using their regression model, so I would want to see a test, if I were doing this I would want to look at a comparable test and I'm sure Mercer's probably did in selecting this. You'd want to look at the test to make sure that the seasonality, if you excluded the seasonality value, that you don't get an improvement in the overall performance of the regression. Those are the kinds of things that you would naturally do. I should mention that when we're doing our regression analysis, we probably examine 30 or so different models for every coverage before we pick one. That's the whole premise of what you're trying to do here. You're trying to find the model that's doing the best job, so common sense has to prevail. You need to make sure that it's, it holds some basis in common sense, some intuitive value.

So just flying through hopefully the remaining charts that I have like this, this is page 15. This deals with property damage severities as opposed to loss costs. Our two regression models are fairly far apart but, so that this is one of those physical damage coverages where Mercer's preference is to use a fairly significantly shorter historical period than we do. In terms of the power of the regression, their model explains about three-quarters of the variation that's exhibited in the data, our model explains about 93 percent based on the R bar squared. Their seasonality statistic does not pass the T test at 95 percent. We don't need a seasonality statistic. Bear in mind, the only reason why the seasonality variable needs to be there is because you're using accident half year data which they represent improves precision. Property damage frequencies on page 16, once again we have a fairly significant different view in terms of the expectation for change. Mercer takes the position that a very short historical period should be used for curve fitting purposes. They use five, ten accident half years, with some data points possibly excluded. I don't recall right now. You can see that our past and future annual trends are different and part of that is because we've introduced an unemployment variable into ours and that appears in green towards the bottom of the screen. I mentioned yesterday that we test the sensitivity in curve fitting purposes to the economic cycle using the unemployment variable with every one of the coverages that we are estimating here, look for the statistical significance of the unemployment variable. In this instance, we found it to be statistically significant and it improved the fit by including it. I'll be coming back to this. But what's shocking here is the R squared statistics that comes out of the Mercer model. It's .59 percent. That's just over half of one percent of the variation in the data is explained by their selective regression model. I can't understand the selection of a model with that low of a fit statistic. It's just ... it's almost off the scale.

(10:15 a.m.)

On page 17, this deals with accident benefits loss costs. I've got two Mercer columns here because I'm not actually sure which model. There were two provided in the package of information provided to me in response to interrogatory FA-2.0. They're fairly similar to each other but I'm not sure which one Mercer ended up actually using as their recommendation. They actually conclude that they should only be looking at frequency and the severity for accident benefits isn't really forecastable, or not ... they choose not to use the severity element. And they have an expectation for an annual trend of 4.9 percent or 4.7 percent compared to what we had of 4.1 percent. The R squareds and R bar squareds for their models are considerably below the R bar squared or R squared values for our model, so the strength of the regression is certainly called into question. I might mention that the test level for the R bar squared, what, the point at which I chose to turn it to red for this presentation was 67 percent. That's the value of the 67 percent, that's basically two-thirds. I have seen in the literature as being a sort of a threshold where a regression model probably should not be selected if it doesn't explain at least two-thirds of the variation in the history. That also happens to be the threshold that was previously used by the regulator in New Brunswick, for what that's worth. The T tests we all pass, so that's good.

Moving to page 18, private passenger collision severities, we're a fair bit apart in terms of our fitted trend values. The strength of our regression is considerably above the Mercer selection, which is just bordering on the 67 percent level for the R bar squared, but it passes so it's a regression. I have a lot more confidence in our value than in theirs, and bear in mind what we're trying to seek here is the pattern of change that we're expecting to go forward.

Collision frequencies on page 19, again they've taken a very, very responsive posture for forecasting purposes here. They've used, I believe, only five years or ten accident half years with some data points possibly excluded. The R bar squared and R squared statistics are very low and the T statistic for both time and seasonality both fail. That's telling. When you don't get the time statistic to pass, that's really what we're talking about in the regression here. We're trying to see how things change through time, and this test is telling you that their regression model, the time variable isn't meaningful. That's troublesome. This also happens to be one of the coverages where we included an unemployment variable that was not included in their model. I'll come back to that in a second.

Comprehensive severities at page 20, all the T tests are passed. We're fairly close actually in terms of the annual trend selection. Our regression model, I would say, is a little bit more reliable than theirs in terms of the goodness of fit, the amount of variation that's explained by the model, but we're fairly close to each other on that. And then private passenger comprehensive frequencies, the fit statistic, the R bar squared is borderline, it's kind of low. I mean, I'm not very happy with ours being down at 83 percent, so I wouldn't think Mercer's was very happy with theirs being at 58. But once again a real major concern here is that the time variable does not pass the T statistic test, the T test. That's telling you that time is not a statistically significant contributor to this regression model, and that's really what we're trying to get at here, so that's a difficult one to hang your hat on.

MR. STAMP, Q.C.: Mr. Pelly, you mentioned already that the R squared and R bar squared were, I guess, common types of analysis used by the actuarial profession.

MR. PELLY: And statisticians in general.

MR. STAMP, Q.C.: What about this T test, is that something ...

MR. PELLY: Similar. It's a standard statistical test. It's all part of standard regression analysis techniques.

Now, there are tables provided on page 15 of the Mercer Report where Mercer's is demonstrating, I think trying to demonstrate that their fits are superior to the fits used in the application by saying here's the actual history of severities and here's, here are the fitted severities that come out of the application and here are the fitted severities that come out of the Mercer recommendations, and, look, the Mercer fits are closer to the actual data than the fits that come out of the regression in the application. Well, I would submit that that's probably not too big a surprise. You're looking at the five latest years here. Our regression model uses a longer history than their regression model, so if you're going to shorten your regression, your history, you're naturally going to be closer to the history in absolute terms, which is what they're measuring here, than any kind of a regression based on a longer-term average. It just, it's intuitive to using a shorter history. So what's more important is how, I believe, are the kinds of statistics that we get about the R squareds and the R bar squareds, the performance, the strength of the regression, how much of the variation inherent in the data is actually being explained by the model. So I can't really accept the presentation being shown on page 15 as being terribly instructive, primarily because it doesn't recognize the strength of the regression.

The other point I'll make on this issue is what we're using these regressions for is to determine rates of change and not absolute values of either the frequencies, the severities or the loss costs, so arguing that the fact that it doesn't come as close in absolute terms to the actual data, we're not trying to use this to forecast the data point, we're using it to determine rates of change, so it's a little bit off topic too.

The next issue that Mercer raises with respect to trend is the use of the unemployment variable. They explain that this, I think they quantify the extent to which this affects the overall ... no, I can't tell you that. I don't know that. They argue that the inclusion of an unemployment variable in the regression is, or they would recommend against use of an unemployment variable in the regression because it's ... whether or not the unemployment variable is meaningful to the regression depends significantly upon how much of a history you're using and they note that in the previous application in the analysis that we did, the May 2001 application, there is a coverage where we did not include the unemployment variable that we did include at this time, and they argue that the significance of that is that that undermines the strength of what you're getting out of the use of the unemployment variable. We did include the unemployment variable in a couple of coverages. It usually arises when you're doing regressions on frequencies. In principle what you're looking for is whether or not the economic cycle has any, and we're using the unemployment variable as a surrogate for the economic cycle, whether or not the economic cycle has any correlation with claims experience. Intuitively I think one can accept the fact that that's a possibility and I'll give an example. On a coverage like comprehensive that includes theft coverage on vehicles, it's arguable that when times are tough there may be more crime and one kind of crime that may occur would be car thefts, and in fact it's not uncommon in some jurisdictions to see a very strong correlation between unemployment rates when they're higher, theft rates on vehicles are higher, so we look for evidence of a statistically strong relationship between unemployment rates and the statistics that we're fitting, be it loss cost frequencies or severity, and that's what we've done in our analysis. We ended up finding that unemployment was a statistically significant variable for property damage, frequencies and collision frequencies, and just as a reminder I've included exhibits that come from the application. This particular example is for property damage tort, so this is page ...

MR. SAUNDERS, PRESIDING CHAIRMAN: 21. Page 21, Mr. Pelly.

MR. PELLY: I have it at 22, I think.

MR. SAUNDERS, PRESIDING CHAIRMAN: I'm sorry. You skipped 21, did you?

MR. PELLY: I went by it quickly.

MR. SAUNDERS, PRESIDING CHAIRMAN: You went by it quickly, okay.

MR. PELLY: The blue fitted line ... these are just like the graphs we saw yesterday. The blue fitted line includes an unemployment variable in the regression. It's a statistically rigorous regression. It has a good fit statistic that's summarized in some of the preceding exhibits. In this instance, with a coverage like property damage tort, the argument, the intuitive argument for unemployment variable would be that when times are tough, people might use their vehicles less for less essential tasks, undertakings, consequence being that they'll, there will be correspondingly or there could correspondingly be less exposure and therefore lower frequencies. The same is true on collision coverage, which is this graph on page 23, and this again is frequency. It's a statistically strong regression, includes the unemployment variable, and we're confident, we're comfortable with the quality of the forecast.

The final area that Mercer's takes issue with on trends is the decision we make to make a distinction between past and future frequency trends in a particular instance for the comprehensive coverage. Flipping to page 24 of the BGP ... is it 2 or 3, I'm sorry? Is this BGP-2 or 3, the coloured sheet?

MR. STAMP, Q.C.: Three.

MR. PELLY: Three. Appearing before you here is the, on page 24, is the fitted and actual history for frequency for private passenger for comprehensive, and we made the conclusion, we drew the conclusion that frequency trend, while we're prepared to recognize the movement in claims frequency that the historical data has shown evidence of, we are not prepared to project it continuing to decline, so you can see that the blue line follows a downward sloping pattern over the fitted period that we have here, which is 1990 to 1999, but going forward from 1999 we've judgmentally chosen to forecast a flat frequency trend, no future change in frequency. Now, Mercer doesn't actually use the regression model that we use here, but they're arguing that we shouldn't make the distinction, we shouldn't override the fitted value and that we should continue with a future frequency of whatever that downward slope would be. That's my understanding of their position. And given the flatness of the last five or six data points, those actual red data points, I would find arguing for a continuing decline in claim frequency for this coverage difficult to support, difficult to defend, and that's the reason why we limit the downward movement in the forecast. We're trying to build an expectation for the future. Claim frequencies cannot decline, cannot continue to decline indefinitely, they have to bottom out at some point in time and the recent historical data is not showing a continuation of the earlier declines. It's bouncing around and hovering around a flat line. That's why we've done what we've done. So in combination with loss development, this trend issue and loss development combined account for about 15 points of the 17 points of difference of opinion between our work and Mercer's work.

MR. STAMP, Q.C.: So the trend is about 3 percentage points of the 16.9 and the loss development is about 12 of the 16.9 for private passenger.

MR. PELLY: That's correct.

MR. SAUNDERS, PRESIDING CHAIRMAN: Would this be a good place?

MR. STAMP, Q.C.: This is a fine time, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: Thank you. We'll return in 15 minutes.

(break)

(10:45 a.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: Sorry we're a few minutes late but we were catching up on the commentary surrounding the pictures on the business page of the Telegram this morning.

MR. STAMP, Q.C.: I haven't seen the paper.

MR. SAUNDERS, PRESIDING CHAIRMAN: Oh, I see.

MR. WHALEN, Q.C.: I hope it's not all that humorous, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: I was only referring to the pictures. Okay, are we ready to resume?

MR. STAMP, Q.C.: Yes, sir. Mr. Chairman, during the break I provided Mr. Pelly with a copy of the Milliman and Robertson Report that was filed the last time. You made mention of it and you asked about it so I've asked him to, maybe he can refer to something in that that deals with a point we talked about.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MR. PELLY: In the Executive Summary from that Milliman and Robertson Report dated September 29th, 1999, there's a series of bullet point summary items that they identify. One of the, the third last ...

MR. O'FLAHERTY: Excuse me, Mr. Chairman, sorry I've lost ... which document are we referring to?

MR. PELLY: This is the report commissioned by this Board by their then consulting actuary.

MR. SAUNDERS, PRESIDING CHAIRMAN: I think that's been distributed to ... yes, you have it, don't you?

MR. PELLY: It was entitled "Facility Association Report on Review of Causes of Operating Surpluses," dated September 29th, 1999, and signed by Chris Suchar and Bill Vogan (phonetic) of Milliman, Robertson Inc.

MR. SAUNDERS, PRESIDING CHAIRMAN: We'll give Mr. O'Flaherty a chance to locate it there now.

MR. PELLY: I wasn't going to dig into it in any detail. I was simply going to read the two bullets.

MR. O'FLAHERTY: Oh, go ahead then. That's fine. If you're going to read it, it'll be in the transcript.

MS. NEWMAN: Just for clarification, this has not been entered in this proceeding, I don't believe, has it, to my knowledge?

MR. STAMP, Q.C.: No. I'm just giving it to ...

MR. PELLY: I made reference to it.

MR. STAMP, Q.C.: He made reference to it, the Chair asked about it and I've provided it to Mr. Pelly for that purpose, to clarify the question from Mr. Saunders.

MS. NEWMAN: If you could perhaps reference the pages that you're referring to ...

MR. PELLY: Certainly.

MS. NEWMAN: ... and we'll circulate those to the parties after unless the parties feel they need them right now to ...

MR. SAUNDERS, PRESIDING CHAIRMAN: It's a part of the Board record, I guess, and we can accept it as that.

MS. NEWMAN: Just to have it for information purposes, we can do that.

MR. PELLY: I'm reading from page three and four, which is the total of the Executive Summary of Findings appearing in that report just mentioned, and the fifth point raised in the Summary of Findings reads as follows, and I quote, "The methods and major assumptions used in all of the filings reviewed (from 1987 through 1996) were reasonable based on the information provided," excuse me, "information available at the time. We did not detect any systematic bias towards over or under-estimation." And the next bullet point appearing at the top of page four states, "The main reason for the over-estimation in the filings from 1992 through 1995 was unexpectedly favourable loss development in 1996 and later which we do not believe could have been anticipated based on the data available at the time the filings were made."

MR. O'FLAHERTY: Mr. Chairman, if I'm not mistaken, that really echoes what the Board found in the order that was filed in respect to the hearing that this gentleman is referring to, is that correct? Are we talking about the same hearing?

MR. SAUNDERS, PRESIDING CHAIRMAN: We're talking about the hearing in 2000, is it? Yes.

MR. O'FLAHERTY: About the issue of profits, very widely ...

MR. PELLY: I think the Board's position ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MR. PELLY: ... ended up mirroring ...

MR. SAUNDERS, PRESIDING CHAIRMAN: That's right.

MR. PELLY: ... the position taken by their ...

MR. O'FLAHERTY: I've got that order.

MR. SAUNDERS, PRESIDING CHAIRMAN: It's the same order, yeah.

MR. STAMP, Q.C.: Now, Mr. Pelly, we had done discussion, you had completed your discussion on private passenger loss development factors and on industry trends.

MR. PELLY: There's one more mention about those tables that I provided, comparing the fit statistics between the Mercer trends and the trends from the rate application. I was working from photocopies of faxes of very small print when I was working with the Mercer exhibits. It's possible that I got a digit wrong and I'm happy to be corrected because I was struggling with reading some of the numbers and I will certainly amend the exhibit and go on record as amending it if I can be provided with an original at some time, but I did the best I could with the numbers that I could read. The other piece of information I'll bring to this board, on the break I contacted my office, I had previously talked about the commercial automobile New Brunswick uninsured automobile premium that had been approved in New Brunswick, and I wanted to try and find out what had been approved, and a base premium of $19 has been approved in New Brunswick for that coverage. That happens to correspond with what is still being proposed in the current application here in Newfoundland and Labrador.

I'm now moving to page 18 of the Mercer Report. I'm dealing with the issue of unallocated loss adjustment expense provision or ULAE provision in the vernacular. Towards the end of the first paragraph under that heading, the Mercer Report states and I quote, "Since the time the FA conducted its analysis, the IBC's data to derive the industry ratio has been released for accident year 2001. The new factor, 1.082, is lower than the factor used by the FA (1.093). We find the updated factor to be more appropriate and recommend its use." Well, I guess I can agree on one thing with what Mercer's has said there, and that's that it wasn't available at the time we used it. I cannot fathom this as a criticism of the application. I don't understand how we should have been expected to use something that wasn't available. I can understand that it's arguable that the Board in its deliberation over the application could consider the possible impact of updating the statistic for purposes of understanding how that might affect the indications, but representing this as something that should have been done in the application is, I think, unreasonable. New data becomes available all the time and the process of developing rate indications takes time. Now, admittedly, the application was submitted in September and that probably post-dates the time of release of the updated statistic with respect to the 2001 loading for unallocated loss adjustment expenses, but in order for us to have gone back and re-stated the work that we had done, we would have had to have gone back to the Actuarial Committee, the Rates and Rules Committee and the Board of Directors in order to re-visit the decision to file, and it's just an impractical suggestion. I also note that in Mercer's own work in providing responses to FA 2.0 and 4.0, which was undertaken in the last month, where we asked them to provide the basis for their calculations of trends, they in fact are using ULAE ratios for 2001 that aren't updated in their own work and that work was being done after the date when this data became available, so holding it out as a criticism that it wasn't used in the application is extreme. I can tell you that there's all kinds of information that becomes available after work gets done. That's a natural course of flow for the reality of the way information flows out of IBC, out of, even the internal within Facility Association, but we can't hold everything up all the time. We have to begin the process.

MR. STAMP, Q.C.: Mr. Pelly, just on the value of this issue on the 16.9 or so percentage points or 17 percentage points that differs in your indications and in Mercer's indications, what does this account for in their opinion?

MR. PELLY: Mercer's estimate of the significance of this issue is about one percentage point of the overall difference, so one point out of the seventeen points.

The next area that is addressed in the Mercer Report is the analysis of third party liability experience, and Mercer recommends that the separate analysis of bodily injury and property damage should be carried forward separately farther than we do in our application. We do do a lot of analysis on bodily injury and property damage separately, and I think we are of a like mind with Mercer on the fact that there's real value in doing that, and Mercer's position, as I understand it, is that we should carry that separate analysis a little bit farther than we do now through the stage of forecasting provincial loss costs. I think primarily their point of view on this is that the credibility standard that might be attached to the property damage coverage is likely to be different than the credibility standard that would be attached with the bodily injury component, so therefore the ability to be responsive to Facility Association experience for property damage might be enhanced by moving to a split analysis through to that stage. I am certainly prepared to agree that the concept deserves further study and I intend to take the idea back for consideration in future filings. In total, Mercer's estimates that this alternative approach might estimate about one point of the seventeen point difference in overall rate level.

The next issue touched on by Mercer in their report, I jump to page, well, they do touch on territory analysis and class and driving record analysis on pages 20 and 21. they really don't take issue with anything that we've done there so I'm really only focusing on differences of opinion here, so I move on to page 21 under the heading, "CLEAR Rate Groups."

(11:00 a.m.)

Mercer finds that use of a more recent in force file would be preferred. We use a December 200 in force file and they're suggesting that using something more current would be preferable, so I'm inclined to agree. I always like to use the most recent data available. There are some practical constraints on the ease with which this kind of information can be assembled. The process of gathering this particular body of data, the in force file as at December 2000, was a significant undertaking to get data as of the same date from all Facility servicing, Facility Association servicing carriers. It was also a significant undertaking to have the Vehicle Information Centre of Canada undertake the dislocation analysis. It took some time for VICC to complete their dislocation analyses, considerable amount of time actually, and as the opportunity arose for a subsequent rate filing, we undertook to include it, include the implementation of CLEAR in with that rate filing, and really what we're seeing here today is the reality of how long this process took to unfold. Once again it's really not practical for us to go back and go through that whole process unless it's deemed to be essential to the Board's decision. I would submit that it's unlikely that the nature of Facility Association's fleet of vehicles and how its, the characteristics of its fleet changed through time compared to the characteristics of the industry fleet. I submit that that's unlikely to be materially affected by updating it. I can't prove that without updating it but I don't expect that there would be a major change in finding found by moving this. There is evidence in the information provided at December 2000 that Facility Association's fleet of vehicles is more heavily skewed towards older vehicles and the dislocation study that arises from that work done by VICC is more concentrated around a small, in a neighbourhood of relatively modest dislocation than anything I've seen as a voluntary market company. I've assisted a few different companies to do dislocation studies for implementation of CLEAR and involuntary market companies that I've seen, the dislocation is much broader, much wider spread, and I suspect that the reason why Facility Association's is more concentrated is a characteristic of the fleet of vehicles that they tend to insure.

The second point that Mercer makes is that they recommend imposing caps on the dislocation and in effect phasing in the implementation of CLEAR rather than moving to full CLEAR in one step. Adopting that recommendation from Mercer has significant implications for Facility Association in terms of the expense that would be necessary in order to accomplish the objective of mitigating the dislocation that, at whatever level is deemed to be excessive, and I remind the Board that if you were comfortable with the level, that threshold level adopted by the Ontario regulator, that being plus or minus 35 percent, approximately one-third of one percent of Facility Association vehicles, according to the dislocation study, are subject to extreme dislocation. That's a pretty small percentage of the overall fleet. It represents about 25 vehicles out of the fleet of vehicles in the December 2000 fleet, and while I acknowledge that movement to CLEAR does create dislocation for those 25 vehicles, significant dislocation potentially, there's a good chance that with the turnover that exists in Facility Association, it's much higher than in the voluntary market. A lot of people are in the Facility Association two years because of the fact that they seek to get out, and therefore they don't actually experience the dislocation because they're either new into Facility Association or not being renewed by virtue of finding a home in the voluntary market, so dislocation is not as prevalent an issue in the residual market for that reason alone. In the cost versus benefit of implementing a phasing in, you're dealing with servicing carriers here instead of one entity, so in the case of Newfoundland we've got four servicing carriers. Any systems changes that are necessary to accomplish the phasing in has to be incurred four times, because we've got four servicing carriers, so one needs to balance the issues of cost versus benefit in the determination of whether or not the dislocation is extreme and of sufficient concern to justify the effort necessary to mitigate that dislocation. I should also mention that CLEAR has been embraced by this Board in its own benchmark, so as a concept CLEAR is not at issue. It's virtually an industry standard, it's widely adopted in the voluntary market, and, once again, Facility Association is just seeking to fall in step with industry practice as is its normal process, and at this point in time FA has had approval to implement CLEAR without taking any steps to mitigate dislocation so far in all jurisdictions other than Nova Scotia and Newfoundland and Labrador, and in both instances we have pending applications there.

Finally for private passenger vehicles, the last area of discussion relates to accident conviction surcharge schedule and specifically for private passenger vehicles, the clean driver discount. Mercer recommends denial of the proposed changes or they cannot recommend that the Board approve the changes, and I think, as I understand it, the grounds for this recommendation is the lack of support for the changes and the fact that that lack of support doesn't allow them to assess their reasonableness. I would contend that you can't, the lack of support certainly doesn't allow you to assess the reasonableness in an actuarial context. The filing is quite open about the fact that there's no actuarial support for those values for the proposed changes to the tables and the introduction of the new discount. What we are seeking to do is to introduce the discount and the changes to the table to bring some uniformity in our practices across jurisdictions, to bring what I've heard Mr. Simpson describe as behaviour modification features into the structure, the rating structure of Facility Association, to bring incentives and disincentives into the process, to encourage good driving behaviour and punish driving behaviour, but also in the case of the clean driver discount, to acknowledge that there can be people in Facility Association who aren't there for the normal reasons that you would expect for a residual market. They're not there because of their accident record or their conviction record, and the ten percent discount is an acknowledgement of, yes, you're in Facility Association, but you're not there for the typical reasons and we want to be able to give some acknowledgement to that in terms of rate. So the structure that is being proposed, while judgmentally based, just as is the current surcharge of accident and conviction surcharges, schedule of accident and conviction surcharges, it's a fit in with the current schedule. It's made to mesh in with the current schedule. It's made to increase the size of the surcharges in a controlled manner over the current level and provide some offsetting rate relief for the better drivers in Facility Association. So while it has no statistical support, it does have intuitive foundations that I think non-actuaries can embrace, and I would ask the Board to give that consideration.

MR. STAMP, Q.C.: Mr. Pelly, I think you may have spoken about this earlier, yesterday perhaps, about the connection between the discounts on the one hand and the surcharges on the other hand. How are they connected or what's the significance of having approval in one or the other or both?

MR. PELLY: Well, they've been presented as a package and it's an integrated package in the sense that the quantification of the rate level impact of these changes has been estimated as a package, so it's, any consideration of splitting up the package is necessarily going to have rate level implications and those would have to be quantified and dealt with accordingly.

MR. STAMP, Q.C.: Does that complete the analysis or the comparison on the private passenger side of things, Mr. Pelly?

MR. PELLY: It does, and really we have a lot of parallels and most of the comments that I have remaining on the Mercer Report for commercial vehicles have a parallel in what I've already said on private passenger and I expect I will be able to pass through it at a little bit faster clip. There are parallels but there are also differences in significance. The first issue identified by Mercer relates to loss development and really they take the same basic argument with our work in that regard.

MR. STAMP, Q.C.: And what's the value on the commercial side of things, Mr. Pelly, when you look at this particular topic? It was 12 points approximately of the 17 or so points on private passenger. What is it here?

MR. PELLY: I should mention that the total difference in opinion with respect to the indicated change in average rate level is summarized on page three of the Mercer Report for commercial vehicles. The application is proposing a rate level change of 48.3 percent, Mercer is recommending a rate level change of 30.7 percent, so it's still a very significant rate level change but about 17.6 percentage points below what we are recommending, so again we have about a 17 point difference of opinion and this particular issue about loss development accounts for about 2 percentage points of that 15, so the relative significance, the change in emphasis here from private passenger, is that, in the private passenger scenario the loss development issue is the driving issue of the difference, in this case it's not the loss development issue. In fact it will prove to be the trend issue, which we'll come to momentarily.

Now, we do use a lot of Atlantic data in our analysis of commercial loss development and Mercer agreed with that but they still are making a recommendation for use of a five-year weighted average with no exclusion of data points, so I have a few slides similar to the ones that you saw for private passenger that take us through the exclusion of data points. This relates to commercial vehicles, bodily injury. There's a black dot, we're all familiar with the black dot, in the third development interval. The black dot is one of the excluded data points. I'm on page 25, I believe I'm on.

MR. SAUNDERS, PRESIDING CHAIRMAN: It's called, "Mercer Issue, Commercial Development Exclusion of Data"?

MR. PELLY: That's correct.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MR. PELLY: And then the chart itself, if you read, if you can read the small print, is labelled, "Facility Association Commercial Vehicle, Bodily Injury, Loss Development Factor Selection." In this instance we have a black dot appearing in the third development interval, so this is an excluded data point of one of the five latest data points. We characterize that black dot as being an outlier, not in the vicinity of the recent history or in this instance, even of the long-term history. That's the reason why the data point was excluded. Without dwelling on it, the next page, page 26, is for property damage. We excluded two data points in the first development interval. The three remaining data points are all clustered around the selected value. While the two excluded data points do fall within the range of the longer-term historical view, they are in our view not sufficiently responsive to the latest experience. Page 27 relates to accident benefits. I think in this instance there are no excluded data points, so I guess we don't really have an issue. Page 28 relates to collision. There are two excluded data points in development interval two and development interval four. The four remaining recent historical data points are so tightly clustered that you can barely see them hidden by the red dot in the development interval two, and they are hidden in development interval four. In fact there are very few yellow dots off of the red line. The only dot that's significantly off the red line in either the second or the fourth interval is the point that we excluded, and that's why we excluded it. For our commercial vehicles, comprehensive, on graph ... sorry.

MR. SAUNDERS, PRESIDING CHAIRMAN: 29.

MR. PELLY: 29. The two data points excluded in the first development interval and they were the low value in the long-term history and again the philosophy being we're seeking to make a, build a reasonable expectation going forward.

(11:15 a.m.)

Moving on to the next area, this is on page 24 of the Mercer Report, is to do with loss trends. Their focus is on three different coverages, first of all, bodily injury and then property damage and collision, and there's really two different issues here.

MR. STAMP, Q.C.: And, Mr. Pelly, before you start this particular topic, what is the value approximately of this difference in position?

MR. PELLY: This accounts for, by Mercer's estimate, this accounts for approximately 15 percentage points of the 17.6 percent, percentage points difference of opinion.

MR. STAMP, Q.C.: For commercial.

MR. PELLY: For commercial vehicles.

MR. STAMP, Q.C.: Right.

MR. PELLY: So this is the bigger issue, the biggest issue of difference that we have. There are two sub-issues, one relating to what we've done on the bodily injury coverage and the other relating to what we've done on property damage and collision. So I'll deal with bodily injury first. In the first complete paragraph on page 25 of the Mercer Report, Mercer states and I quote, "We find FA's estimated trend for bodily injury to be unreasonably high." And then they go on to make reference to the winter storm, severe winter of 2000, 2001, and conclude, although I don't see it right here but I know I've read it, oh, here it is, sorry, it's the second sentence in that paragraph, and I quote, "We note that the worst winter in history, late 2000, that carried into 2001, inflated the loss experience for two half accident year periods, 2000-2 and 2001-1, and as a result the loss cost trend estimated by FA is inflated since FA, as FA does not exclude these data points from its regression analysis." That's correct, we did not exclude those data points from our regression analysis so we're agreed on that. The question is why didn't we exclude them?

For purposes of trend analysis, as I've already stated, we use a statistical test for identifying outliers in the regression. The test is designed to distinguish data points that don't appear to be within a reasonable range of what you are trying to determined as the fitted pattern of change through time. It's a statistical test, it's based on a calculation of the standard deviation of the differences in the fitted versus actual data points, and if there's a data point that is more than a certain number of standard deviations away from the fitted line, then it's flagged as an outlier. Now, the Mercer regression line that they're recommending and the regression line that we're recommending are not identical lines, so therefore any application of an outlier test are going to be different for that reason because we've got two different starting points, but in our analysis, the approach that we took to doing the analysis and the regression curve that we were gravitating towards, did not identify the winter of 2000, 2001, as being unusual, as being not characteristic of the flow that the earlier data was demonstrating was expected in 2000 and 2001.

On page 30 of BGP 3, most of this graph is data that I presented earlier yesterday, most because I didn't have the green line on the chart yesterday, but the red line and the blue line are just like we saw yesterday. This is commercial, bodily injury loss cost information. The red line or the, is the actual history and the blue line is the fitted line that we selected based on our analysis and the regression to that actual history. We excluded data points in the regression, and, as I mentioned yesterday, you can identify those by the years for which there's no blue dot on the blue dotted line, so that would be 1993 and 1998 were excluded based on the statistical outlier test, but 2000 and 2001 were not flagged as being outliers and the regression is a reasonably solid performing regression. If you've now become educated in R squareds and R bar squareds, it had an R bar squared of 95 percent, it passed all the "T" tests, it was a strong performing regression, and these points, the 2000 and 2001 data points, were not deemed to be outliers based on an analysis of the amount of variance in the data. Mercer's in its review was using accident half year data to fit but they did prepare fitted accident year data points based on their analysis of the accident half year data patterns, and that's what I've plotted on this graph using the green lines and green data points, and they're fitting their data to a shorter history than we are. That's in keeping with their position that the trend analysis should be more responsive, and they consider the two data points, well actually two half year data points corresponding to the winter storm periods, to have been extreme. Now, I don't know what the criteria that Mercer uses to make the decision about whether to include or exclude a data point, so I can't comment on how they came to the conclusion that those two points were outliers. They've drawn the conclusion that the winter storm was the cause of the abberation. I would just give the committee a moment to go back to Slide 2 in this package.

MR. STAMP, Q.C.: Is that the second page in or the third page in, Mr. Pelly?

MR. PELLY: Second page in, after the title page. This is the corresponding exhibit for private passenger loss costs for bodily injury coverage. The storm that occurred, and I was here for some of it, if I recall, the storm that occurred in the winter of 2000/2001 would have affected private passenger vehicles too. They were on the road at the same time as those commercial vehicles, and I characterize this trend as being a reasonably well behaving trend line in terms of the actual data. It was a fairly easy process to do the fit and Mercer's in its review of the trends of private passenger loss cost didn't feel it was necessary to make any exclusions, didn't identify any abberation attributable to the winter storm, and I find it difficult to understand how a winter storm could have focused its impact only on commercial vehicles, so is it reasonable to conclude that the storm, given the absence of evidence of that storm on the private passenger side, is it reasonable to assume that these two half year data points, the whole cause and effect of that is the winter storm? It may be that that's some of the contributing elements but we can't get away from the fact that it's real data. It did happen. The statistical analysis of the pattern of change through time didn't flag these data points as being outliers, not in our regression, so we included the data points and the consequence is that our fitted line is responsive to those data points and it's steeper than Mercer's line, so you have competing actuaries with competing points of view. I have confidence in our regression line simply based on our analysis of the experience and I believe that our forecast for the future is a reasonable forecast given the evidence of the past.

The other area of trend for which there was some disagreement was on property damage and collision coverages. Mercer's preference was to use Atlantic data instead of Newfoundland data, and we had used Newfoundland data in the application, but they didn't take issue with the use of Newfoundland data, but they did feel that our choice to make an assumption about future frequency trends being flat for these two coverages was unreasonable.

Oh, sorry, I didn't finish with bodily injury. My apologies. I had another slide that I forgot about. This is a similar chart to what we had on private passenger trends and I've only included it to provide the comparison of what is coming out of the Mercer fit versus for the application. You can see that their trend, annual trend is about 8.4 percent per annum compared to our 11 1/2. They're both strong performing regressions. They both have pretty significant fit statistics in the R bar squared. Ours is higher value but they're both good values. The seasonality statistic failed the "T" test, so there's some question as to whether or not the regression, the inclusion of the seasonality regression variable is meaningful in the fit of the regression curve. Presumably it was tested to see what happened if you excluded the seasonality variable and the conclusion reached that despite the low "T" statistic, this was the preferred, in their view, this was the preferred regression, so there's just the one question of the seasonality regression variable there, and I apologize but now I am up to property damage trend.

The recommendation from Mercer on property damage is that we should have assumed a continuation of the decline in claim frequency for property damage, and that is what I've characterized with the green line as a continuation of the blue fitted line that we've calculated up to 1999.

MR. STAMP, Q.C.: This is page 32 of the package, I take it, Mr. Pelly, is it?

MR. PELLY: That's correct. We came to the conclusion much like I showed for comprehensive and private passenger, we came to the conclusion that there had been a pattern shift, that the last several years of claim frequency is showing evidence of a flatness that is not typical of the earlier history, so we chose to fit a regression line to the longer-term view but to cap its forecasting direction at a level that roughly corresponds to where we sense that the claim frequencies have bottomed out and to forecast a flat frequency trend going forward. In due course when we have enough data points, in this instance from 1996 onwards, where the pattern sort of appears to have changed, when we think we've got enough data points beyond that change, we will start using a regression line that's fitted to that more recent data provided it's meaningful, but until such time as we reach that point, we're inclined to go forward with an assumption of a flat frequency trend. Forecasting a continuing declining claim frequency when we have a relatively flat pattern in the last five or six years just does not sit well with me.

MR. STAMP, Q.C.: Does this chart seem to suggest that that red line is actually climbing, I guess, the last three or four years?

MR. PELLY: Well, it's always difficult to know when a new trend has started or whether it's just randomness in the data, but you can see that in the last three data points, the movement is upward. I'm not sure that this is a new pattern change, that we're now back into a cycle of increasing claim frequencies, and rather than reacting with an assumption that we are, we have reached that point, I'm just reacting to dampening the direction of the longer-term view of a downward movement by dampening it to a flat trend going forward.

(11:30 a.m.)

On collision frequency, which is the other coverage for which they take issue, it's a little bit of a confusing issue because we also have an unemployment variable in this regression, so we don't actually cap ... but we cap a future frequency trend, but the consequence of our doing that cap is that we are not forecasting an increasing frequency trend going forward, which is what comes out of the previous regression. I could have shown it on the graph what the future frequency trend was being forecasted to be on this but I chose not to because I don't really think that was Mercer's intention. Their intent was that we should just continue on with the pattern of change that's been exhibited in the past and the regression model over the past period had an implication of a declining frequency. The regression model for a future period was actually suggesting there should be an increasing frequency and I was not prepared to embrace a forecast of an increasing frequency when I'm still of a sense that I've got a relatively flat recent historical period, so we chose to project future frequency at a flat level going forward from 2001. Mercer's recommendation is that if there's a period, implication of decline in claim frequency from the recent past, you should carry it into the future. And, once again, the differences of opinion on trend account for 15 points of the 17 points. I would think most of that is attributable to the bodily injury issue, so that's a very important issue for the differences between our forecast and Mercer's re-statement.

MR. SAUNDERS, PRESIDING CHAIRMAN: Just a point, Mr. Stamp, I'm a little confused with the numbering. How many pages in total do you have in this document, 32? I'm ...

MR. STAMP, Q.C.: I have 33.

MR. SAUNDERS, PRESIDING CHAIRMAN: You have 33.

MR. STAMP, Q.C.: I have one more ...

MR. SAUNDERS, PRESIDING CHAIRMAN: You have 33?

MR. STAMP, Q.C.: If you count the title page.

MR. SAUNDERS, PRESIDING CHAIRMAN: If you count the title page as one ...

MR. STAMP, Q.C.: Yes.

MR. SAUNDERS, PRESIDING CHAIRMAN: ... you have 33.

MR. STAMP, Q.C.: Yes, sir.

MR. SAUNDERS, PRESIDING CHAIRMAN: I must have miscounted because Commissioner Martin tells me that you're right, so I'm not going to hold up the proceedings.

MR. STAMP, Q.C.: Well, actually, I relied on the start point you gave us, Mr. Commissioner.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes, and I've lost track, so ...

MR. STAMP, Q.C.: Well, when you started, when we started that, I guess, labelling some of these pages, I think it was number 12 or so ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MR. STAMP, Q.C.: ... that was your count that we went with, so ...

MR. SAUNDERS, PRESIDING CHAIRMAN: So you went from 12 ...

MR. STAMP, Q.C.: I went from 12 with you.

MR. SAUNDERS, PRESIDING CHAIRMAN: Alright.

MR. PELLY: Mr. Chairman, if you find that you have an incomplete copy, we can remedy that.

MR. SAUNDERS, PRESIDING CHAIRMAN: I don't think so. I've found all the charts that you've referred to. It's just that my numbering is probably gone askew there somewhere, so I don't want to hold up the proceedings to fix that.

MR. PELLY: Very good.

MR. WHALEN, Q.C.: We should probably correct that now in case we're referring (inaudible) pages.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. Let me see, let me just quickly run through here. I have the problem. I have two 15's. That's what threw me. Okay, thank you.

MR. PELLY: The next area of difference of opinion expressed by Mercer in their report relates to the unallocated loss adjustment expense provision. This is really the very same issue that I previously discussed with respect to private passenger. In this instance they attribute about one-half of one percentage point as the significance of this issue in the total difference of opinion of about 17.6 percentage points, so it's a relatively minor issue other than the point that I think their position is extreme.

MR. STAMP, Q.C.: Mr. Pelly, just to recap now on these numbers, did you tell us that the premium value for private passenger was about $11.4 million?

MR. PELLY: I did.

MR. STAMP, Q.C.: And that the premium value for commercial is about $623 million, I think you said.

MR. SAUNDERS, PRESIDING CHAIRMAN: Thousand.

MR. STAMP, Q.C.: I'm sorry, $623,000.

MR. PELLY: Yes, $623,000 is about an estimate of the unlevel written premium.

MR. STAMP, Q.C.: Alright. And so when we're looking at the values you've talked about, the 17 points on private passenger, which seems to be the spread between your position and that of Mercer's, and the, about 17 1/2 or so percentage points on the commercial side, could you just explain to us, if you can, what those differences in percentage points mean to the $11.4 and, $11.4 million and $623,000?

MR. PELLY: Well, as a gage of that, if you take 17 percent of either the $11.4 million or the $623,000, that gives you a dollar value estimate of the significance in premium volume terms for the private passenger versus commercial differences of opinion.

And the final area of discussion where there's a different viewpoint expressed in the Mercer Report relates to the accident and conviction surcharge schedule. Really the issue, I think, is the same as expressed for private passenger vehicles. They recommend against approval of the schedule change on the grounds again that they have no basis for assessing its reasonableness, and I would again argue that there's an intuitive basis for assessing its reasonableness. It seems that there's some confusion over the intent of the filing as to whether or not the accident conviction surcharge schedule changes are intended to encompass all classes of vehicles. As I stated yesterday, that is the intent, and the basis upon which that would be accomplished was discussed yesterday.

There's also in their third point, they take some issue with the use of data for one servicing carrier as a representative sample for purposes of calculating the off balance or the rate level impact of the schedule change, and there was some concerns expressed with respect to that data. I believe we did respond to an interrogatory that maybe shed some light on their concern in that regard. I'll mention that the data that we were able to get to help us do this off balance calculation was provided by, was requested of several servicing carriers but was only able to be provided by one of them in a manner that allowed us to do the kind of calculation that we needed to do. This was a special non-routine request that the servicing carriers attempted to do to the best of their ability, so it's a non ... we necessarily have to work with the data we have available to us. The way that the data was presented separated the experience into private passenger versus non-private passenger, so for purposes of doing the commercial calculation, we had to use data that encompassed classes of vehicles beyond just commercial vehicles. In other words, it captured things that, other things that were not private passenger. That's an imperfection. It would be better if we had commercial only data. A lot of things would be better if we had better data. That's a reality of what we have to deal with when we're doing rate-making work. We try to use data that's as relevant as we can and we did observe very good general consistency between the private passenger and the non-private passenger off balance calculation. If you take out the clean driver discount impact in the private passenger piece, they're very very similar, very very close together. That gave us some comfort in using the non-private passenger data for virtually any other class of vehicle that we need to because of that consistency. So I guess in conclusion on that point, we're using the data we were able to get to allow us to put forward a proposal for this change for purposes of calculating the rate level impact of that change.

MR. STAMP, Q.C.: Mr. Pelly, there was one further point I was going to ask you to deal with. We had talked about the, I guess, relative volumes of market share in some of the jurisdictions you are engaged with for Facility Association in doing rate filing, and I'm going to ask you to look at two particular documents, you've seen them before, and just to explain to the Board, to the panel what it is that these two exhibits depict, please.

MR. SAUNDERS, PRESIDING CHAIRMAN: Do you want to label those, Mr. Stamp?

MR. STAMP, Q.C.: Yes, I think it's 4 and 5. Perhaps the single page could be 4.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

<u>EXHIBITS BGP-4 AND BGP-5 ENTERED</u>

MR. STAMP, Q.C.: Mr. Pelly, looking at BGP-4, the single page ...

MR. PELLY: I have that.

MR. STAMP, Q.C.: ... could you just explain to the Board what this is attempting to depict?

MR. PELLY: The vertical axis on the left-hand side reflects the Facility Association market share, and I believe that's an exposure market share, so it represents Facility Association's market share based on vehicle count, so five percent would imply that Facility Association represents five percent of the industry in a particular jurisdiction in a particular accident year in terms of vehicle count. The horizontal axis represents a percentage by which Facility Association average written premium compares to industry average written premium.

MR. STAMP, Q.C.: So the industry is at 100 percent?

MR. PELLY: The industry represents a 100 percent base. The farther to the right on the chart that a particular data point appears, the bigger the gap that exists between Facility Association average premium and industry average premium, and this what you might call a scatterplat (phonetic). It shows a collection of data points that happen to correspond with different accident years in different jurisdictions in which Facility Association operates. There's a legend at the bottom of the page that helps you interpret which data points relate to which jurisdictions and the particular data points that relate to Newfoundland and Labrador also have been labelled by which data point corresponds with which accident year.

There are two observations that I make when I look at this particular exhibit. One is that there appears to be some correlation between the Y on the vertical axis and the horizontal axis. If you hold it at a distance and squint your eyes, you might try and fit a line to something like this, it would be a line sloping from the top left to the bottom right that would characterize the relationship such that the wider the gap that exists between Facility Association rate levels and industry rate levels, the smaller Facility Association's market share would be expected to become. The other interesting observation is that Newfoundland and Labrador stand alone. They have a tighter relationship between Facility Association and industry rate level and they tend to have a higher market share than is exhibited in the other jurisdictions, so it speaks for itself in terms of how Facility Association's existence in Newfoundland and Labrador is impacting the voluntary market. We clearly, Facility Association is clearly having more business insured through Facility Association and this (inaudible) suggest that there's some relationship, cause and effect relationship here with the fact that the rate level for Facility Association is closer to the voluntary market. I believe it was my evidence at the previous hearing that if there is a gap, a bigger gap between Facility Association and industry rate levels, that leaves more room for non-standard market insurers to participate and compete, if you will, for the non-standard market, some of which ends up in Facility Association in the absence of those voluntary market companies that might write that business otherwise.

(11:45 a.m.)

MR. STAMP, Q.C.: That's fine. Mr. Pelly, just looking at the second exhibit, BGP-5, is isn't the same series of jurisdictions, but perhaps you can just tell us what is depicted in this series of charts.

MR. PELLY: In this instance we have really overlapping information in some respects with the market share information presented on the previous page, other than the fact that we have a longer history presented and it's presented in a different form. There's one page per jurisdiction, and I guess what we have here are the four Atlantic jurisdictions, and the percentage market share is shown just below the corresponding bar for those who are more numerate. As you glance through the various exhibits, you will see in the other Atlantic jurisdictions that there, although the timing and the magnitude varied a little bit, there was a period of declining market share for Facility Association of late for which there really, in a timeline sense there is no parallel for Newfoundland and Labrador, although 2000 and 2001 market shares are lower than the immediately prior years. We don't have the same historical fall and apparent re-growth that was evident in the other Atlantic jurisdictions. Clearly the different jurisdictions, if the correlation of BGP-4 holds true and you're going to expect the, some relationship between Facility Association rate levels, industry rate levels and market share, then the different dynamic of Facility Association's experience in seeking rate levels in other jurisdictions compared to Newfoundland and Labrador will have a bearing on how market share evolves, and perhaps this graph is representative of that.

MR. STAMP, Q.C.: Mr. Chairman, I think that this may be the conclusion of the direct examination. I would ask, if it's convenient to the panel, could we take the break that's set for 12:00 a few minutes early and I'll make sure that there's nothing further, and then if we come back perhaps we can just proceed with the cross-examination right away and uninterrupted.

MR. SAUNDERS, PRESIDING CHAIRMAN: Certainly, sounds like an idea.

MR. STAMP, Q.C.: Thank you.

MR. SAUNDERS, PRESIDING CHAIRMAN: Alright. We'll be back at five after. Thank you.

(break)

(12:05 p.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, Mr. Stamp, what have you decided?

MR. STAMP, Q.C.: All done, Mr. Chairman, thank you.

MR. SAUNDERS, PRESIDING CHAIRMAN: You're all done. Mr. O'Flaherty, are you ready?

MR. O'FLAHERTY: Ready to proceed, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: Very well.

MR. O'FLAHERTY: Can I ask you, Mr. Pelly, if you have a copy of the FA filing with you?

MR. PELLY: I do.

MR. O'FLAHERTY: And a copy of the Mercer report?

MR. PELLY: I do.

MR. O'FLAHERTY: And a copy of the Intervenor's pre-filed evidence, which is the blue volume, perhaps over your right shoulder.

MR. PELLY: Okay, thank you.

MR. O'FLAHERTY: I'm going to start out with some issues upon which I think that we're going to be able to agree. You work with Eckler and Partners Limited.

MR. PELLY: Agreed.

MR. O'FLAHERTY: And I understand there are two main practice areas of Eckler's, are there two main practice areas?

MR. PELLY: I think I would say there are three.

MR. O'FLAHERTY: Okay, what are those three main practice areas?

MR. PELLY: Financial services, pension and benefits, and actuarial evidence.

MR. O'FLAHERTY: And I take it that no member of your firm is an insurance agent, or an insurance broker, or an insurance company?

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, so the relationship between Eckler and Partners and the FA is that of consultants and actuaries to a client?

MR. PELLY: Correct.

MR. O'FLAHERTY: Now, how long has FA been a client of Eckler Partners Limited?

MR. PELLY: I moved to Eckler Partners in 1993. During my first period of time at Eckler Partners, we were engaged by Facility Association, but not as their principal actuarial consultants, and we were re-engaged as their principal actuarial consultants, I think it was either the spring of '95 or ... I think it was the spring of 1995, but subject to check.

MR. O'FLAHERTY: And do you have any personal, did you have any personal involvement with the FA file prior to coming to Eckler Partners Limited?

MR. PELLY: I did.

MR. O'FLAHERTY: Can you tell me a bit about that?

MR. PELLY: My previous employer in its various incarnations, because it went through some name changes, the property casualty consulting practice there was involved in consulting to Facility Association since its inception and to Facility, which was a forerunner organization to Facility Association, prior to that.

MR. O'FLAHERTY: So is it fair to say that you worked with a firm for whom FA was a client, then you moved to Eckler and Partners, or sorry, Eckler Partners Limited, and FA again became a client, and there was an interregnum, or a period of time in which they weren't a client of yours?

MR. PELLY: Well, they remained a client throughout that time, we just weren't the principal advisors.

MR. O'FLAHERTY: Okay, and would your involvement with the previous firm take you right back to the inception of FA as an organization?

MR. PELLY: Yes.

MR. O'FLAHERTY: So for the entire period that FA has been in existence, you have worked with a firm for which FA was a client?

MR. PELLY: Yes.

MR. O'FLAHERTY: Now does your personal practice involve assisting your clients in complying both with rate approval regulatory requirements and with financial reporting requirements?

MR. PELLY: Some clients, yes, I do both kinds of work. Some clients I only do one, some I do the other.

MR. O'FLAHERTY: And you are an actuary, we've talked about your qualifications, and you're qualified as a Fellow of the Casualty Actuarial Society, and the Canadian Institute of Actuaries?

MR. PELLY: Yes.

MR. O'FLAHERTY: I just want to ask you a couple of questions about what actuaries do and what they don't do, so I can understand the scope of my questions. In terms of your training and expertise, I understand you are an expert in actuarial science?

MR. PELLY: That's a very broad statement. I mean there are a lot of disciplines within actuarial science, but I'll accept that.

MR. O'FLAHERTY: Are you an expert in the area of statistical analysis, or is that a separate discipline?

MR. PELLY: I wouldn't consider myself an expert, no.

MR. O'FLAHERTY: Okay, so ...

MR. PELLY: I'm a user, but I'm not an expert.

MR. O'FLAHERTY: Okay, that's what I expected, so when, for example, you're reviewing BGP-4 or BGP-5, the two exhibits you were looking at just before the break and drawing conclusions from them, that's not based on your expertise as an actuary?

MR. PELLY: Well, I guess, my whole working life I have been employed either as an actuarial assistant or an actuary, so my exposure in the insurance industry is grounded in that. Sometimes it's difficult to know when I'm talking because I'm an actuary, and when I'm talking because I've worked my way through the insurance industry. I recognize that. The particular BGP-4 or BGP-5, they're graphs, and although perhaps the explanation of the content of the graph is quasi-actuarial, I would say that the interpretation of the graph is not actuarial, it's just interpretive.

MR. O'FLAHERTY: So that's something for another discipline then, to interpret a graph like that, strictly speaking?

MR. PELLY: I think, subject to an explanation of what's being presented, I would say it's for a layman.

MR. O'FLAHERTY: Well then when you're offering evidence in that regard, then you are doing so as a layman, are you?

MR. PELLY: Well, as I said, I mean I think I provided an explanation as to what information was being provided, and that probably required some expertise. It's not literally actuarial because there are non-actuaries who would have equal ability to be able to explain that exhibit. That doesn't preclude me from being able to do that. Having said that, once a person knows what information is being presented, I would say it doesn't take an actuary. I can't stop being an actuary, but ...

(12:15 p.m.)

MR. O'FLAHERTY: I think I understand. I think the Board's got the point in any event. Now, does an actuary have any specific expertise in the industry to which it provides advice, or sorry, to which he or she provides advice?

MR. PELLY: I would say there's certainly some expertise there, yes, in the industry, they have knowledge of the industry for which, to which they consult.

MR. O'FLAHERTY: Do you claim expertise, for example, in issues of underwriting?

MR. PELLY: No, I wouldn't claim that.

MR. O'FLAHERTY: So would it be fair to say then that you have a long-standing knowledge of the, of the industry within which your client operates, but you're not an expert in how that industry operates in the same sense as, for example, an underwriter would be, is that a fair statement?

MR. PELLY: Well, I mean an underwriter is a limited field expert too, and we all play in the same sort of league, if you call the insurance industry a league, we all have some general familiarity with what each other does, but I'm not sure who the expert would be in the insurance industry, all in.

MR. O'FLAHERTY: No, and I take your point, very fair, and we could go into the area of claims adjusting, for example, that's a specific area of expertise.

MR. PELLY: Yes.

MR. O'FLAHERTY: And you don't have that expertise?

MR. PELLY: I'm not an expert in claims adjusting.

MR. O'FLAHERTY: Okay, so rather than go through all the different areas of insurance, my basic point was that while you have an understanding and probably a very good understanding of the insurance industry, you're not an expert in any of these particular areas that you've referred to, with the exception of actuarial science.

MR. PELLY: I'll grant you that.

MR. O'FLAHERTY: Thank you. Now, what jurisdictions have you prepared filings for, or been involved in preparing filings for for FA, and you can just give me this year. I don't need to go back any further than that.

MR. PELLY: Well, Facility Association is active in all of the sort of open competition jurisdictions, so that's the four Atlantic Provinces, Ontario, Alberta, Yukon, Northwest Territories and Nunavut, and I have either authored or supported the preparation of a rate application in all of those jurisdictions at various points in time.

MR. O'FLAHERTY: And I take it some of the jurisdictions have tribunals that hold hearings like this one, and others may not?

MR. PELLY: That's correct.

MR. O'FLAHERTY: Now ...

MR. PELLY: I think technically in Ontario they don't categorize themselves as a tribunal, and they don't typically hold hearings, they have the power to hold hearings.

MR. O'FLAHERTY: I would probably be referring to tribunal in the sense of a decision making body.

MR. PELLY: Well, subject to that definition, I think that's fair.

MR. O'FLAHERTY: Okay, now I just want to understand, I've listened with great interest to your testimony and I want to understand, and I think it's important for the Board to understand exactly what the nature of your appearance is here today. Would you agree that the nature of your appearance is typically to present and defend a rate filing on behalf of FA?

MR. PELLY: Yes.

MR. O'FLAHERTY: And that's the nature of your appearance here today?

MR. PELLY: That's my main purpose of being here.

MR. O'FLAHERTY: Okay, now when you are presenting and defending a filing on behalf of FA, do you generally testify in a panel with your client or, you know, does your client generally testify?

MR. PELLY: That's a very jurisdictional-specific question, and it varies by jurisdiction accordingly.

MR. O'FLAHERTY: I just want to understand the general practice. Let's take the last one you were at, I think it was Nova Scotia.

MR. PELLY: Actually, New Brunswick.

MR. O'FLAHERTY: Oh, I'm sorry ...

MR. PELLY: Actually Alberta was the last one I was at, excuse me, sorry. If it's Thursday, it must be Alberta, yeah. Yeah, Alberta was the most recent hearing I attended. I attended with two other representatives from Facility Association. We, it's a less formal setting than we have here. You're not sworn in, you basically sit with the members of the Board in Alberta, and have a conversation about the application, so it's a different setting.

MR. O'FLAHERTY: How about Nova Scotia, do you give sworn evidence in Nova Scotia?

MR. PELLY: Yes, and that's a little bit more structured. There's opportunities, there's order to the proceedings, that's not meant as a criticism of Alberta, but that's just a fact, so there's a process that we go through where we provide introductory comments, we give an overview of the application, we talk a little bit about underwriting issues, we respond to questions from the Board panel throughout that stage. In that instance there was a Board expert who had been engaged to review the application.

MR. O'FLAHERTY: I don't want to interrupt you but we're just trying to establish that, you've indicated there's a spectrum of different possible hearings, would it be fair to say that in Nova Scotia it would be more similar to Newfoundland than would Alberta be similar to Newfoundland?

MR. PELLY: I'll take that, yeah.

MR. O'FLAHERTY: Okay, and when you were in Nova Scotia, did your client testify?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, now BGP-1 is your, and you don't need to refer to it, it's your CV, and it just, there's a point that I wanted to bring up. It indicates that you also act as an actuarial advisor to regulatory boards.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, in particular, I believe it's New Brunswick is one.

MR. PELLY: New Brunswick is one.

MR. O'FLAHERTY: And is Alberta another?

MR. PELLY: Manitoba.

MR. O'FLAHERTY: Manitoba, I'm sorry, Manitoba. Okay, would you agree that the role that you fulfil for the Manitoba and New Brunswick Board is similar to the role which is filled by the Board's actuaries present here today?

MR. PELLY: I'll acknowledge that there must be similarities, but I don't know the details of the engagement here.

MR. O'FLAHERTY: Well, do you see a distinction between those two roles, on the one hand advising a Board, a regulatory Board, and on the other hand, in presenting and defending a rate filing application?

MR. PELLY: One involves originating work, the other one involves reviewing work originated by another, but actuaries have a responsibility under their rules of professional conduct and standards of practice to behave appropriately under either circumstance and hopefully we all do that.

MR. O'FLAHERTY: Well, I'm certainly not calling into question the appropriateness of your behaviour, I just want to suggest to you that on the one hand you are acting as both an expert in actuarial science and an advocate for your client's filing, but on the other hand, if you're advising a regulatory board, you are only providing advice on actuarial science, is that a fair statement?

MR. PELLY: Well, I guess I'm acting also as an advocate of the Board's interests when I'm advising the Board, but yes.

MR. O'FLAHERTY: Yes, it's a fair statement?

MR. PELLY: Yes, it's a fair statement.

MR. O'FLAHERTY: Okay, thanks, so part of your role here today is as an advocate on behalf of the FA filing, rather than as an actuarial expert?

MR. PELLY: Well, I'm the author of the Facility Association filing so I'm here to defend it, if that makes me an advocate ... maybe I need a definition of the word "advocate".

MR. O'FLAHERTY: Well we'll get into who has authored the different portions, but I think you follow with where I'm going with this, in any event, and you agree that part of your role today is different from the role you would be playing if you were sitting in the chairs which are occupied by your colleagues?

MR. PELLY: Absolutely.

MR. O'FLAHERTY: Thank you. Now as you've indicated, you are listed as one of the authors of the filing, and there's another actuary with your firm, and perhaps you could turn to the first page, it's Milene Labelle *(phonetic)*, I hope I have that name correct.

MR. PELLY: Pretty close.

MR. O'FLAHERTY: Okay, are you the principal author or a co-author of this filing?

MR. PELLY: I'm the more senior of the two authors. I am the partner responsible for this application in the firm, and Milene Labelle is not a partner in the firm, but she's a fully qualified actuary. She was a very, very active participant in the preparation of all the analysis in the filing. I was too, an active participant, but not as substantially involved in all of the details as she would have been. I am still here to defend the filing and am sufficiently familiar with the details to hopefully address all of your questions.

MR. O'FLAHERTY: Can you hear me well enough if I don't hunch over right into the microphone?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, because it's much more comfortable, thank you. Can the Board still hear me?

MR. SAUNDERS, PRESIDING CHAIRMAN: I can hear you, I don't know about our recorder. Yes.

MR. O'FLAHERTY: Yes, okay, thanks.

MR. SAUNDERS, PRESIDING CHAIRMAN: You'll hear from him if he doesn't.

MR. O'FLAHERTY: Thank you, Mr. Chairman, would you happen to know the date upon which the assignment was received from FA regarding this filing?

MR. PELLY: This filing arises out of an annual review cycle that we undertake for Facility Association, so to identify ... I guess in a literal sense the request to prepare a filing arose the day the Facility Association board of directors finalized the decision to proceed with a filing, and that happened approximately the middle of July of 2002. I could find the date.

MR. O'FLAHERTY: And what is the approximate date of the completion of the report? Can we accept the September 6th date as the completion?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, so the timeframe for preparation and there's a review and approval process as well, of course, which we're going to review, of this filing, that's from July of 2002 up until September of 2002.

MR. PELLY: All of the analysis would have been done prior to the board meeting and prior to the meetings of the actuarial committee and rates and rules committee before that, but the assembly of the exhibits and the preparation of the filing documentation would all follow in that period that you identified.

MR. O'FLAHERTY: So then prior to July of 2002, you're performing the actual preparation of the indicated rate level changes.

MR. PELLY: That's the essence of it, yes, for ultimate presentation to the board of directors for direction as to how they wish for us to proceed.

MR. O'FLAHERTY: I think you've indicated previously that that's the primary role of the actuaries in this document is to prepare the indicated rate level changes for the client.

MR. PELLY: The actuarial portion, the departure from the indications to the word "proposed" is not strictly the actuarial aspect of the work.

MR. O'FLAHERTY: So do you prepare an initial or draft filing for FA's consideration?

MR. PELLY: No.

MR. O'FLAHERTY: How does that process work then that something gets put down on paper?

MR. PELLY: Facility Association, its various committees, and its board of directors, and its staff, are well familiar with what is going to be proposed, and with what was indicated underlying that proposal prior to the time that I complete this rating application, but the details that are provided in the rating application are, are our concern. We need to provide enough information to adequately, hopefully, support the proposal, the indications that are underlying the proposal.

MR. O'FLAHERTY: Okay, so do I understand, and please correct me if I'm wrong, do I understand you that the narrative portions of this particular document are actually initially prepared by FA?

MR. PELLY: No, by us.

MR. O'FLAHERTY: Okay, well that's what I was asking you then. What is the, when do you prepare ...

MR. PELLY: You asked if I prepared a draft for review by Facility Association and I don't. I prepare the filing and I submit the filing. On behalf of Facility Association I prepare the filing and I help Facility Association draft the covering letter under which the filing is submitted to the regulator.

MR. O'FLAHERTY: Perhaps it's just a question of semantics, I just want to understand, at the start of the document, the filing, there are 22 pages of narrative.

MR. PELLY: Of narrative. That's all us.

MR. O'FLAHERTY: Right, when is that document prepared?

MR. PELLY: Over the period of time prior to submission, shortly prior to submission, so it would have been in the last weeks of August and the early weeks of September, early week of September.

MR. O'FLAHERTY: So then this document is prepared after the internal review and approval process is done?

MR. PELLY: Yes.

MR. O'FLAHERTY: Oh, okay, that clarifies it, thank you. So what ...

MR. PELLY: It's a substantial investment in time and if there is no direction to proceed to a filing, then we don't want to invest the time to do the work.

MR. O'FLAHERTY: And you mean to prepare the narrative portion.

MR. PELLY: Prepare the narrative and prepare all of the exhibits.

MR. O'FLAHERTY: All the exhibits, okay.

MR. PELLY: Each jurisdiction has different specific filing requirements.

MR. O'FLAHERTY: Sure.

MR. PELLY: And that necessitates a certain amount of effort in order to be able to comply.

MR. O'FLAHERTY: This is not the first time that you've been the principal author of a FA filing in this jurisdiction though.

MR. PELLY: Certainly not.

MR. O'FLAHERTY: And I think it's fair to say, and this is not meant as a criticism, that certain aspects of the narrative are reproduced in the last two reports at least?

MR. PELLY: You will find similarities for sure.

MR. O'FLAHERTY: Okay, now I just want to understand then the process of internal review and approval then, and perhaps you could take me through that.

MR. PELLY: Internal to my firm?

MR. O'FLAHERTY: No, internal to FA.

MR. PELLY: And this is review and approval of the intent to file?

MR. O'FLAHERTY: Perhaps I'm misunderstanding. My understanding was that FA has an internal review and approval system whereby you're involved with that.

MR. PELLY: Let me describe the sort of unfolding of what leads to this and maybe it will answer your question. The process begins with the Insurance Bureau of Canada starting to release the latest accident year industry and Facility Association experience. That typically begins in the latter, maybe the last week of May or usually the early week of June, and we start the process of extracting, reconciling, and reviewing the claims experience. We work with Facility Association staff as the facilitator for our work in certain areas where we need information from servicing carriers to help us finalize some assumptions during that same stage, but basically we're advancing the work on loss development trend, classification analysis, territorial analysis, expense provisions, payout patterns, whatever we're analyzing, we're advancing that work, leading up to a meeting of either the actuarial committee or the rates and rules committee. These are both internal committees staffed by volunteers from the voluntary market, and sort of coordinated with Facility Association staff.

Those two committees have different roles in the review process. You would probably guess that the actuarial committee has a bit of an actuarial slant to it. The rates and rules committee has a more practical, hands-on, street perspective about what makes sense to proceed with an application given these are the indications, and I spend time with both of those committees to lead towards the rates and rules committee making a recommendation to the Facility Association board of directors.

I then attend the Facility Association board of directors meeting, usually in conjunction with the chair of that committee, where we present the indications, the rates and rules committee recommendations for filing, and provide whatever rationale or discussion in support of that recommendation from the rates and rules committee is necessary for the board's, the Facility Association board of directors' deliberation and decision on each incident case. That's what happened mid July, was that latter meeting with the board of directors.

MR. O'FLAHERTY: So you're physically present at these meetings with the actuarial committee, the rates and rules committee, and the board of directors?

MR. PELLY: I am, on this particular cycle, the actuarial committee was mostly done by email and conference call, so I wasn't physically present in the same location as the other people, but the spirit was ... yes, I was an active participant.

(12:30 p.m.)

MR. O'FLAHERTY: If they're not reviewing this document, or a draft form of it, what are they reviewing?

MR. PELLY: We prepare special summaries for them, in the case of the actuarial committee, we prepare summaries of the key underlying assumptions and a highlight of the methodology, because that's really what their focus is. For the rates and rules committee, we prepare summaries of the building blocks for some of the, some of the underlying experience for the indications, and exhibits that are designed to facilitate their role in this process, so tables that compare raw, indicated, and current and proposed classification differentials or territorial relationships and things like that. The exhibits are slanted towards their respective roles, and are designed to facilitate that review process. Some of those same exhibits appear in this application.

MR. O'FLAHERTY: So then the same types of assumptions and variables and selections that you take issue with with the Board's actuary, that's the material that's being reviewed by the actuarial committee of FA?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, and issues regarding such things as the accident surcharge schedule and the deductible issue, those are issues that are going to be reviewed by the rules and rates committee?

MR. PELLY: The rates and rules ... most typically, yes.

MR. O'FLAHERTY: Rates and rules committee, and then by that process together then, you're going to take a package to the board of directors and seek approval?

MR. PELLY: To get approval to proceed in accordance with the rates and rules committee recommendations.

MR. O'FLAHERTY: Did the, in this particular case, did the actuarial committee make any recommended changes to your assumptions or variables or selections?

MR. PELLY: Specifically in Newfoundland?

MR. O'FLAHERTY: Specifically in Newfoundland. Perhaps you can check that and we can be advised of it. I don't want to ...

MR. PELLY: I believe the answer is no.

MR. O'FLAHERTY: Okay, can you confirm that, please? And similarly, if we look at the other part of the filing, that is the issues that are not strictly actuarial issues, and we've discussed underwriting issues ... can you tell me whether or not the rules and rates committee made any recommended changes to that aspect?

MR. PELLY: Well, those aspects we wouldn't have originated.

MR. O'FLAHERTY: Okay.

MR. PELLY: So it doesn't arise.

MR. O'FLAHERTY: Okay, so that ... so if I have questions about those particular aspects of the filing, they didn't originate with Eckler Partners Limited in any event? That's where your consulting role is here today.

MR. PELLY: That's a fair statement. I mean because I would have been there at the birth of the idea with the committee I have familiarity with the discussion that arose and that gave rise to the issue, but it didn't originate with my firm or me.

MR. O'FLAHERTY: Or in the same way that, you know, if Mr. Stamp had been there, he would be able to speak to it as well, but it would be second-hand information, wouldn't it?

MR. PELLY: I don't know whether it's second-hand or not, I mean I was there at the time when it arose.

MR. O'FLAHERTY: Okay, thank you. So then we get to the board of directors' review, do you know in this case whether there were any changes made at that level of the review?

MR. PELLY: My recollection is that the board of directors accepted and approved of the recommendation from the rates and rules committee for Newfoundland and Labrador, but I should check that too.

MR. O'FLAHERTY: Can you confirm that, please, and at that level I take it they wouldn't make, would they be making changes to any of the actuarial assumptions? And that's not meant as a ...

MR. PELLY: Very unlikely, there is an actuary on the Facility Association board of directors, so it's conceivable.

MR. O'FLAHERTY: Can you just confirm that as well?

MR. PELLY: That there was no change?

MR. O'FLAHERTY: Or if there was and what ...

MR. PELLY: On the actuarial assumptions there were none.

MR. O'FLAHERTY: Okay, so that's a physical meeting where you're present at that time?

MR. PELLY: That one was. Sometimes I have attended by phone there too.

MR. O'FLAHERTY: I just, I want to take an example so I understand exactly what we're talking about, the types of changes. One of the changes that was highlighted this morning was the change from using, the use of half yearly data, accident experience data, to yearly accident experience data, because I note in your prior filing, you were using half yearly data.

MR. PELLY: For portions of the analysis, that's right.

MR. O'FLAHERTY: For the major portion, the bodily injury portion, is that not correct?

MR. PELLY: For that coverage we updated it using accident half year data, that's correct.

MR. O'FLAHERTY: So would that be the type of change then that would be made internally by, that decision, would that be made Eckler Partners Limited, or would that be made by FA?

MR. PELLY: The decision to use accident half year data, it was really dictated by timing. The original, the previous filing was submitted in May of 2001, which in the normal cycle is late in the process.

MR. O'FLAHERTY: Right.

MR. PELLY: Our previous experience with this Board is that they are sensitive to the timeliness of the experience underlying a particular application, and when an application is newly fresh into the Board and is based on somewhat stale data, I'm in agreement with them on that point, so my advice to Facility Association before we submitted the filing was that it should be refreshed and updated, at least in the material, like you said, the significant area is bodily injury, with more current data to address what is otherwise likely to arise as a concern coming back to us from the Board. It's reasonable ...

MR. O'FLAHERTY: Your evidence is that in the preparation cycle then, and for the previous filing, which I don't want to delve into, but at that particular time the choice to go with the half year data was your decision?

MR. PELLY: I made a recommendation to staff and they saw the merits of doing that.

MR. O'FLAHERTY: Okay, and now this time you've switched back to yearly data.

MR. PELLY: Because we're back in the normal cycle, yes.

MR. O'FLAHERTY: And is that again based on your recommendation?

MR. PELLY: Sure, yeah, it's based on the flow of time that we would normally be going, and we have, we don't need to deal with the half year ... when you move to the half year data it does complicate the analysis, and if you can keep it simpler and still appropriate and reasonable and in accordance with accepted actuarial practice, that's a preferred approach because it just puts less issues on the table to be addressed as concerns.

MR. O'FLAHERTY: Okay, alright, I want to pass on to another topic. In your, in your filing document here, well FA's filing document, does this follow a standard format for FA reports?

MR. PELLY: Portions of it are similar to the kinds of filing documents that we prepare in jurisdictions where an actuarial document is required. Not all jurisdictions require the formality of a defence, paper defence of the application.

MR. O'FLAHERTY: I just wanted to talk to you briefly about the structure of the report and see if I understand the report itself. In the first part of the report you have a summary of findings, I believe?

MR. PELLY: Yes.

MR. O'FLAHERTY: That would be section one, and then section two, you have a review of the provincial rate level indications.

MR. PELLY: Yes.

MR. O'FLAHERTY: Now, I understand that the rate level indications are, in fact, represented by the percentage change to the current average rate levels, is that correct?

MR. PELLY: Yes.

MR. O'FLAHERTY: And the third chapter is the provincial, or third section is the provincial ...

MR. PELLY: Territorial.

MR. O'FLAHERTY: Sorry, territorial indications.

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, and chapter four is the differentials to be applied to the individual base premiums, I guess, for a consumer?

MR. PELLY: Yes.

MR. O'FLAHERTY: And chapter five is the issue of the surcharges?

MR. PELLY: Yes.

MR. O'FLAHERTY: And then we've got Appendix A, which is your actuarial data in support of the private passenger vehicle aspect of the filing.

MR. PELLY: Yes.

MR. O'FLAHERTY: Appendix B is the commercial data.

MR. PELLY: Yes.

MR. O'FLAHERTY: And Appendix C is something called regulatory required information, something to that effect?

MR. PELLY: Something to that effect.

MR. O'FLAHERTY: Now, I want you to go to the summary of findings, please, this time?

MR. PELLY: Okay.

MR. O'FLAHERTY: Okay, and I take it generally from the narrative in this section that the purpose of the report is to review the adequacy of the rates.

MR. PELLY: Yes.

MR. O'FLAHERTY: The current rates.

MR. PELLY: The current rates.

MR. O'FLAHERTY: When were the current rates established?

MR. PELLY: They arose from the May 2001 application. Off the top of my head I don't recall what date they became effective.

MR. O'FLAHERTY: I'm going to suggest to you that I think the Board order was December 2001, and they became effective in May of 2002. Does that sound ...

MR. PELLY: That sounds about right.

MR. O'FLAHERTY: About right? Okay. Now, I understand in terms of the, what are the current rates that are being charged in Newfoundland, those are based on loss experience up to the end of 2000 ... is it 2000 AIX is the basis for the current rates?

MR. PELLY: The current rates arose from the May 2001 filing. The May 2001 filing was substantially based on the 1999 AIX, with an update for bodily injury to the first half of 2000, so the 2000 dash one AIX if you want to label it, but that application addressed private passenger vehicles and certain miscellaneous classes of vehicles ... the commercial, the previous commercial application was sometime prior to that. I think that was the December '97 application.

MR. O'FLAHERTY: Fair point, okay, so in terms of the private passenger vehicle analysis, we're updating rates that are based on the 2000 AIX, and you've indicated 2000-1 AIX. I had understood that the Board's actuary had recommended that that material be updated to the end of 2000 loss experience. Do you recall that?

MR. PELLY: Not specifically, no.

MR. O'FLAHERTY: Is that possible that that's the case?

MR. PELLY: Well, the filing was submitted in May of 2001. The 2000 AIX would have started to become available about a month after that.

MR. O'FLAHERTY: Yeah, the summer, right.

MR. PELLY: The Board's review process proceeded over that time and through the summer so it's, it's a possible position for the Board to have taken.

MR. O'FLAHERTY: Okay, and this filing is dated September 6th, as you pointed out, so this is based on the 2001 AIX.

MR. PELLY: It is.

MR. O'FLAHERTY: Now, I'm going to suggest to you that the previous filing for private passenger vehicles is based on the 2000 AIX, and you don't recall right now whether it was updated to consider the latter part, but assuming that it is, then is not this new filing that you've prepared based significantly, the changes are significantly based on the 2001 AIX data?

MR. PELLY: Yes.

MR. O'FLAHERTY: Now, when you prepared your last filing, sorry, when the last filing was prepared, I take it that would have been, you know, based on reasonable actuarial assumptions at that time?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, and the amount, and I'm speaking from the top of my, you know, from memory now, but the amount that was actually ordered by the Board was quite close to the indicated, or sorry, to the proposed rate level changes and the indicated rate level changes, wasn't it?

MR. PELLY: Well, you're ... it's a matter of degree. It was, I think, about four percentage points, five or six ... I don't remember the detail. I would say about five percentage points ...

MR. O'FLAHERTY: That's my recollection, it was ...

MR. PELLY: ... but below what was being requested in the application.

MR. O'FLAHERTY: You were looking for 13.2 percent on behalf of your client, and I think the Board, after an update, considered the time lag, ordered 10 percent.

MR. PELLY: That sounds about right.

MR. O'FLAHERTY: Okay, so it was quite close then, the indicated rates that you were recommending were quite close to what was ordered by the Board.

MR. PELLY: If you accept that three percentage points is close, I guess that's the case.

MR. O'FLAHERTY: Alright, well wouldn't you agree that the resulting rates should have been adequate, or close to adequate, based on your analysis?

MR. PELLY: Within that three percentage point range at the time, yes.

MR. O'FLAHERTY: Okay, but I take it, based on this application, that they were not adequate.

MR. PELLY: That's the benefit of hindsight, yes.

MR. O'FLAHERTY: Okay, well substantially not adequate because these are quite large changes that you're asking for.

MR. PELLY: Indeed.

MR. O'FLAHERTY: Okay, now you told us earlier the primary role of the actuary is to develop the indicated rate level changes, and these are the first and third of the tables which are shown at page one of the report.

MR. PELLY: Yes.

MR. O'FLAHERTY: And then your client will be responsible for table two and table four, which are the proposed average rate level changes.

MR. PELLY: Basically.

MR. O'FLAHERTY: Now, looking through prior filings and it appears that there is often a gap, and sometimes a very large gap between what's indicated and what's proposed in the sense that, I'm just referring to, off the top of my head. 1997, I believe there was 40 some percent indicated and 27 percent that was proposed, so there's a situation in which, what your advice is on the indicated, the client may actually ask for a much lower amount, would you agree that's correct?

MR. PELLY: That has happened, yes.

MR. O'FLAHERTY: Okay, but in this particular filing, the proposed level, rate level changes are, with some minor exceptions, are the same as what are indicated.

MR. PELLY: That's basically true.

MR. O'FLAHERTY: Okay, can you bring me through the iteration process, how that works, how is that decision made?

MR. PELLY: It originates with the rates and rules committee. They consider a number of different aspects of the environment in which the proposed rates will be put forward. One of the issues that needs to be considered is the timeline. The rate indications are developed with a target implementation date, and our experience in some jurisdictions has been that we don't really come particularly close to realizing the target implementation dates, not ... just because the regulatory review process takes longer than we allowed for.

We don't want to allow for a long time and then have to wait, so we allow for a provision, I guess, for regulatory review, and if it proves to be an inadequate provision, we just bring that fact to the attention of the regulator, as we have today, or yesterday. So one of the considerations is the regulatory environment.

Another consideration is the stability in the indications from one application to the next, or what is driving the change in the indications from one application to the next, because if all ... if everything unfolds exactly as expected from one application, then the expectation in the next application is that it will be logically consistent in terms of whatever was left over as a rate level need in the previous application, plus a little trend, that would be sort of a going-in expectation for the next application. When things don't unfold as expected, when the claims environment changes, or when some other force having an impact on the cost of claims in a particular jurisdiction, then that's an issue of some concern, and if the ... there's a level of comfort with the indication and a concern about the magnitude, that's going to push them towards a more aggressive stance on the proposal.

MR. O'FLAHERTY: So it's fair to say then that one of the considerations is if there's a, you know, if there's a high level of indicated rates that weren't expected, then you're going to get a closer, or one of the considerations which will be taken into account would be bringing the proposed level up closer to the indicated level.

MR. PELLY: That's a natural reaction. I mean they view developing the proposal as being a response to the indicated, and they need to get comfortable with the indicated, and that's what I spend a lot of time with the board of directors, the rates and rules committee, and the actuarial committee is helping them understand why it is what it is. If it's overall generally consistent with the previous filing, that doesn't take so much effort. When it isn't, and that happens, it takes more effort in order to get people to that point of comfort. They, you know, these are all industry people so they have their own books of business, they know something about some of these jurisdictions, and they may have an expectation going in that it hasn't been as expected generally, and maybe that makes it a little bit easier in that jurisdiction, but by and large it's a process of becoming familiar, developing an understanding, and making an informed decision.

MR. O'FLAHERTY: I'm sorry, when I had interrupted you, you were giving what you thought were the considerations. One of them was the regulatory environment, and the other was stability of the indications, or the volatility of the indications, I think that's correct to say. Were there any other considerations?

MR. PELLY: I would say if you go back to some of the older applications, it would have been more frequent to have applied, or to have prepared proposals based on a more tightly capped level off of the indication, and to a large extent, that response has now been more frequently restricted to situations where the volatility is a real concern, one where we can't get comfortable with the volatility. The reason for that is partly a reflection of the way the regulatory environment has evolved, and partly a reflection of the concern from Facility Association, its committees and its board of directors, about rate adequacy, and the consequences for their own voluntary market and for Facility Association operating results of Facility Association not seeking rate adequacy, so there has been a strength and focus on responding more aggressively to the indications.

MR. O'FLAHERTY: So do I understand your evidence in probably layman's terms, that the voluntary market itself sees importance in responding to the indicated levels where there is a large jump, we'll say, in a case like this from last year's indications.

MR. PELLY: Not strictly in the case where there's a large jump, but in a case where there's a rate level need, and they have a level of comfort behind that rate level need, that they have sort of like the actuarial committee has embraced it, the rates and rules committee has embraced it, their own board of directors has either a dependency on those other committees, or an independently contrived, derived comfort level with it, then yes, they have a concern about rate adequacy.

MR. O'FLAHERTY: And who makes up the membership of this particular board of directors?

MR. PELLY: They're mostly senior industry executives from the voluntary market, and there is broker representation.

MR. O'FLAHERTY: And is it fair to say then that there is an awareness that based on the inadequacy of the previous indicated rates and the experience that, the updated experience to 2001 AIX, that there could possibly be assessments due from the industry with respect to that particular change in the loss experience?

MR. PELLY: That, there would be a logical linkage in that thought process.

MR. O'FLAHERTY: I would think so, yeah, okay. Now, I just want to keep going through this document so I understand the summary of, before I go to each of the initial proposals. The next proposal that is in your ... well, first of all, you say it is proposed to adopt the indications in all cases except for specified perils and for commercial vehicles, uninsured automobile. I'm at page two, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: Page two?

MR. O'FLAHERTY: Page two, and it's paragraph three in the narrative, and I think we are in agreement that this is a proposal by Facility to adopt the indications in all cases.

MR. PELLY: Yes.

MR. O'FLAHERTY: The next paragraph says for uninsured automobile it is proposed to cap the commercial vehicle's indication. Now perhaps this is a question of semantics, but when I read it it suggested to me that this should be to peg or to increase rather than to cap, would you agree with that?

MR. PELLY: I'll take that.

MR. O'FLAHERTY: So this again, I take it, is a proposal of Facility Association.

MR. PELLY: It is.

MR. O'FLAHERTY: Okay, and if you look back at the two charts just briefly, and I won't belabour this point, you're indicated as 90.2 percent?

MR. PELLY: Yes.

MR. O'FLAHERTY: And the proposed is 216.7 percent?

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay.

MR. PELLY: On a six dollar ...

MR. O'FLAHERTY: Sure.

MR. PELLY: A six dollar premium.

MR. O'FLAHERTY: It's a very small premium amount but there's a big difference between the indicated and the proposed, so that's not based on an actuarial indication of loss experience.

MR. PELLY: Well, the 216.7 is in the sense that it arises from a comparable analysis that we undertook to get the 90.2 percent in Newfoundland.

MR. O'FLAHERTY: Good point, let me just rephrase the question and we'll move right by this. It's not based on an actuarial analysis of loss experience in the Province of Newfoundland and Labrador.

MR. PELLY: That's true.

MR. O'FLAHERTY: Okay.

MR. PELLY: And we say as much.

MR. O'FLAHERTY: Fair enough. Next paragraph, this is the specified perils proposal, and this looks to me like, I'm sorry, I have to get down to it in my notes here ... is this a proposal ... perhaps you can explain this proposal. This wasn't something that was dealt with in great detail in your initial part of ... I know it's not a major part of the filing but just so I understand what this is about.

MR. PELLY: One of the difficulties of dealing with the specified perils coverage is that it is somewhat lacking in loss experience. It's not an enormously popular coverage for purchase and therefore the experience is certainly more sparse than comprehensive, but there is, there are some parallels between the comprehensive coverage and the specified perils coverage. In fact, the comprehensive coverage embraces, encompasses all of the coverages that are inherent to specified perils, and then some.

Several years ago we established a ... recommended and then established a practice of doing one more step on specified perils, over and above the provincial analysis that we'll be getting to, I expect, in due course of the specified perils experience, and it's almost like a double check to make sure that what's coming out of the analysis for specified perils isn't going to take us somewhere that is counterintuitive, that we are going to end up with specified perils rates that bear a reasonable relationship to the comprehensive rates on, about which we have more confidence, and that's really the objective of this exercise.

MR. O'FLAHERTY: Okay, because I think you'll agree that in both the proposed and ... sorry, both the indicated and proposed numbers, they're both calling for a decrease, yet the proposal is for a lower decrease.

MR. PELLY: That's right.

MR. O'FLAHERTY: Okay, so that's a result that's, I take it, must be arrived at based on a recommendation from the rates and rules committee.

MR. PELLY: Well, actually as a matter of process, I hate complicating things, the final decision on specified perils we reach in the process of finalizing the filing. We don't actually do finalized specified perils even for the board of directors. It's a sufficiently minor coverage that the decision really doesn't hinge on it, the decision to file or not to file, so little hangs on that particular assumption, we give them the indication for specified perils, and we declare that it's subject to some refinement, subject to this double check exercise, which we can't really do until we've got other things completed that need to be approved by the Board. It's a bit of a Catch 22, so the board and the rates and rules committee and the actuarial committee just accept that they don't know the final number for specified perils and understand that we will be doing some refinement of that value before filing.

MR. O'FLAHERTY: I guess my main point about it is that if we look at it from the other, the adverse, okay, where you may have indicated, you've developed indicated rates, for example, for third party liability in territory one, 60.5 percent increase, okay, and then that's adopted as the proposed average rate level change, that's in the first two tables.

MR. PELLY: Yes.

MR. O'FLAHERTY: In the exact same table, of course, if you look over at specified perils, a consumer could expect to, if the same approach was followed, the same consistent approach was followed by FA, they could expect to see a reduction of 28.2 percent, but in this case it goes to 22.8 percent on the basis of an intuitive judgement call.

MR. PELLY: Well, it's still based on an analysis of experience, it's just a supplementary step to the analysis, and it's contained in the, it's ... like the analysis is presented.

MR. O'FLAHERTY: It's a small point, we'll pass on now. The fourth proposal you have is that the filing also proposes to adopt the VICC advisory CLEAR differentials and rate group table for private passenger.

MR. PELLY: Correct.

MR. O'FLAHERTY: Now, this is a major proposal, isn't it?

MR. PELLY: It's an important proposal.

MR. O'FLAHERTY: Okay, it's an important proposal, and this relates to the collision coverage, I take it?

MR. PELLY: It will affect collision, comprehensive, specified perils, and all perils.

MR. O'FLAHERTY: All the physical damage coverage.

MR. PELLY: Excluding property damage tort.

MR. O'FLAHERTY: What is the actuarial role in that proposal?

MR. PELLY: For me personally?

MR. O'FLAHERTY: Yeah, what role does an actuary have in making that proposal?

MR. PELLY: There have been actuaries involved in designing and developing CLEAR. Now that wasn't me.

(1:00 p.m.)

MR. O'FLAHERTY: Let me ask you, let me just cut right to the point, isn't this really an underwriting issue that we're talking about here, rather than an actuarial issue?

MR. PELLY: It's an underwriting rating issue, yes, but the quantification of the rate level impact needs to be acknowledged.

MR. O'FLAHERTY: No, that's fine, but ...

MR. PELLY: And that's an actuarial element that arises from the decision.

MR. O'FLAHERTY: But if I want to ask questions on behalf of consumers as to why adoption of this underwriting or rating proposal is appropriate, then I need to speak to somebody with underwriting and rating experience, don't I?

MR. PELLY: I guess if that gave you more comfort than talking to me that would be fine.

MR. O'FLAHERTY: The next proposed change is the change to from all perils to collision, the ... you want ... sorry, FA wishes to charge a premium for all perils coverage which is the sum of the collision coverage and the comprehensive coverage.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, and is that proposed change arrived at based on an actuarial analysis of loss experience?

MR. PELLY: No, it's not.

MR. O'FLAHERTY: It's not, okay, so the next proposal is a proposal to increase the minimum deductible to $100 and it is also proposed to change the base deductible, and now again it's a semantics point, but should I take it that it's also proposed to increase the base deductible to $500?

MR. PELLY: That's my recollection.

MR. O'FLAHERTY: Okay, so we'll change that then to increase. Now are these proposals arrived at through an actuarial analysis of loss experience in Newfoundland and Labrador?

MR. PELLY: One isn't needed for either of these changes. The decision to change the base deductible is, has no impact on the rate that anybody pays. It's like an internal housekeeping thing.

MR. O'FLAHERTY: Internal to the insurer?

MR. PELLY: Internal to the servicing carrier, in this instance, acting for Facility Association.

MR. O'FLAHERTY: So then the answer would be that it's not based on, or arrived at based on an actuarial analysis of loss experience in this province.

MR. PELLY: That's correct because none is needed.

MR. O'FLAHERTY: Let's have a look at the rate pages that deal with this issue. Do you want to go to the particular change that we're talking about, just so we can (inaudible). Do you know where the rate level, the rate pages are with respect to this change?

MR. PELLY: I believe they're in Appendix C.

MR. O'FLAHERTY: Okay, Tab 9?

MR. PELLY: You might be right, Tab 9.

MR. O'FLAHERTY: So then the proposal is to, in respect of the ... I'm sorry, I had moved on to the next one. This is the commercial vehicles proposed to adopt the comprehensive rate group differentials for specified perils. We won't deal with the deductible right now, I'll just come back to that in one second, and that's at, that's at Tab 10, the next ... or 11, is it, commercial rate pages.

MR. PELLY: The commercial rate pages are at Tab 11, I think.

MR. O'FLAHERTY: Okay, so what's going on here in terms of the numbers, what are we changing?

MR. PELLY: Specifically on the issue of the specified perils rate group differentials?

MR. O'FLAHERTY: Yes.

MR. PELLY: That change will result in the specified perils rates being parallel, and I'll explain that term, being parallel to the comprehensive rates.

MR. O'FLAHERTY: Okay.

MR. PELLY: So that the underlying relationships as you move from one rate group to the next rate group will be the same in percentage terms from specified perils to comprehensive. Previously, the specified perils relationships were actually steeper as you moved from, at the high end from one rate group to the next rate group than was the case for comprehensive, and the concern was that if you go out far enough to a high enough rate group, you can end up with a specified perils premium that's greater than a coverage that has, that offers more coverage, more protection. That just is counterintuitive.

MR. O'FLAHERTY: So this is an issue of, or the rationale of it is based on this notion that it's counterintuitive, but can I just bring you to the effect of it. This is right in the middle of this particular page, isn't it, the actual numbers?

MR. PELLY: Yes.

MR. O'FLAHERTY: So this is where it says comprehensive and specified perils?

MR. PELLY: Yes.

MR. O'FLAHERTY: So these are factors, these numbers here are both for ... let's just take for the comprehensive coverage, that's a factor that's arrived at through an actuarial analysis of loss experience for comprehensive coverage.

MR. PELLY: For the rate group relationships?

MR. O'FLAHERTY: No, for the actual money that's, the actual dollars. At the end of the day, that's how you got those numbers.

MR. PELLY: Not all of the relationships are based on an actuarial analysis. The rate group relativities, for example, are not based on an actuarial analysis. They aren't changing in this application for comprehensive, so it's a carry forward.

MR. O'FLAHERTY: I'm sorry, and I don't want to belabour the point, but if you just take the figure of $58, the one that appears up in the top left corner there, is it fair to say that at some point in time that your company did an actuarial analysis of the loss experience for comprehensive coverage and arrived at this particular number, $58?

MR. PELLY: It would be better for me to say the $197 that appears above it, just slightly to the right.

MR. O'FLAHERTY: Okay.

MR. PELLY: The $197 is the reflection of the actuarial analysis. Getting from the $197 to the $58 involves reliance upon the rate group differential, or the deductible differential, and in this instance, neither of those differentials are based on either a current analysis, nor to my recollection were they ever based on an analysis. It happens that there are limitations in the data available generally, and these are two of the ones that are difficult to address in that respect.

MR. O'FLAHERTY: This is a clear example of me trying to rush through a topic and making it more confusing.

MR. PELLY: I'm just trying to give you an accurate answer, I'm sorry.

MR. O'FLAHERTY: No, I appreciate your specifics and that's very important. Okay, if we go then to the difference between the $197 and the $98. Is it fair to say that the $197 is arrived at based on an actuarial analysis of loss experience for comprehensive coverage in Newfoundland and Labrador?

MR. PELLY: Yes, it is.

MR. O'FLAHERTY: Is it fair to say that the $98 is arrived at based on an actuarial analysis of loss experience for specified perils coverage?

MR. PELLY: Yes, it is.

MR. O'FLAHERTY: Okay, so isn't this proposal, or the effect of it, isn't this to make the $197 for specified perils, is that correct?

MR. PELLY: No.

MR. O'FLAHERTY: No, it's to make it $98, is it, to change the $197 to $98?

MR. PELLY: The $98 is the byproduct, is the outcome of the recommendation that we're making.

MR. O'FLAHERTY: Okay, so then what's happening here is that you're just taking loss experience applicable to one coverage and you want to move it over to another?

MR. PELLY: No, not the loss experience, we're strictly talking about the premiums, as you go down any one of these columns and you move from one rate group, to the next rate group, to the next rate group, there's an underlying percentage relationship there. Previously, in the previous version of these rate pages, those underlying relationships were different between comprehensive and specified perils. What we're proposing is to make those underlying relationships the same, to make specified perils movement as you go down the rate groups in percentage terms the same as is the case for comprehensive.

MR. O'FLAHERTY: Okay, perhaps I misunderstood what's happening. I had understood from reading this that what was going to happen was that the comprehensive rate group differentials would be applied to specified perils coverage in Newfoundland.

MR. PELLY: That's true, the differentials.

MR. O'FLAHERTY: The differentials would.

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay.

MR. PELLY: The differentials are those relationships that I was just talking about.

MR. O'FLAHERTY: Right, right, good point, okay, so at the end of the day then, are we going to see a net increase or decrease to rates charged to consumers who wish to avail of specified perils coverage?

MR. PELLY: For commercial vehicles?

MR. O'FLAHERTY: Yes.

MR. PELLY: Decrease.

MR. O'FLAHERTY: Okay, now last of all there is a proposal in the summary to change the schedule for accident and conviction and surcharges.

MR. PELLY: Yes.

MR. O'FLAHERTY: I understand this is for all FA business in the province.

MR. PELLY: Yes.

MR. O'FLAHERTY: And I also understand, and you've acknowledged this, that this is not based on an actuarial analysis of loss experience.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, alright, I want to turn now to page three of the report, which is the data underlying the filing.

MR. PELLY: Yes.

MR. O'FLAHERTY: That's the issue I want to talk about here. The narrative indicates that in terms of the matters in chapter two, you're relying on FA and industry automobile claims experience up to December 31st, 2001, and with respect ...

MR. PELLY: Primarily.

MR. O'FLAHERTY: Pardon me?

MR. PELLY: Primarily.

MR. O'FLAHERTY: And with respect to the territorial indications though, it's a different set of data.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Can you explain to me why that was necessary?

MR. PELLY: It all has to do with the timing of the release of the different kinds of experience exhibits from the Insurance Bureau of Canada and when we need to do our work. Our work predated the release of the 2001 AIX version of the territorial and classification exhibits, so we relied on the latest version available at that time, so that would have been the 2000 AIX territorial and classification exhibits.

MR. O'FLAHERTY: So then the difference between the different rates among the territories in Newfoundland necessarily relies upon older data.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, and both of these sets of data are prepared by the IBC?

MR. PELLY: That's correct.

MR. O'FLAHERTY: Now, I just want to understand one thing about how the data gets to the IBC. There are, I understand at least from the Intervenor's pre-filed evidence, something in the range of 50 automobile insurers in the voluntary market in Newfoundland and Labrador.

MR. PELLY: I've heard that number too.

MR. O'FLAHERTY: Okay, is it mandatory for those auto insurers to file with the IBC?

MR. PELLY: It is.

MR. O'FLAHERTY: Okay, so then we can assume then that all 50 of those companies would file with the IBC on an annual basis?

MR. PELLY: I believe in the age of electronics, most companies are submitting information more than annually.

MR. O'FLAHERTY: Say that again?

MR. PELLY: More frequently than annually.

MR. O'FLAHERTY: Oh, more frequently, okay.

MR. PELLY: I think in some cases it's done daily.

MR. O'FLAHERTY: So that's the one data set, that's what you refer to as industry.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, so we're not talking about Atlantic Provinces data, industry means Newfoundland and Labrador data.

MR. PELLY: It could mean Atlantic data too but industry means it's the collective of all automobile insurers in the province or region.

MR. O'FLAHERTY: Okay.

MR. PELLY: Depending upon what you're speaking of.

MR. O'FLAHERTY: So the industry then is the voluntary market.

MR. PELLY: Not precisely. The industry, when the Insurance Bureau of Canada publishes industry data, that is inclusive of Facility Association.

MR. O'FLAHERTY: Alright, and then the Facility Association data is excluded for the purpose of the benchmark study?

MR. PELLY: I believe that's a truthful statement.

MR. O'FLAHERTY: Anyway, the point was that in terms of the Facility data, you're dealing with a much smaller data set, aren't you?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, and that comes from, in this province, four servicing carriers?

MR. PELLY: Correct.

MR. O'FLAHERTY: And all are required to file with IBC?

MR. PELLY: That's right.

MR. O'FLAHERTY: Okay, and in some cases, or at least one case in this filing, you're relying on an even smaller set of data from one of the Facility servicing carriers, I understand.

MR. PELLY: That's correct.

MR. O'FLAHERTY: And that was a six month picture of experience you took out there?

MR. PELLY: It was for some distributional data we needed.

MR. O'FLAHERTY: And that was for expenses.

MR. PELLY: Oh, no, the expense information didn't come from the AIX, the expense information came from internal Facility Association accounting information, and that was for ... I could check, but less than a year period, but it was for all of FA in this jurisdiction.

MR. O'FLAHERTY: Now one of the points you're making in this paragraph is that all the data that you've looked at is unaudited, am I correct on that?

MR. PELLY: I might need you to define unaudited, but to the best of my knowledge there is no auditor hired to come in and review the data by IBC.

MR. O'FLAHERTY: I was following up on your, your statement.

MR. PELLY: I don't do an independent audit.

MR. O'FLAHERTY: Pardon me?

MR. PELLY: I do not do an independent audit of the data.

MR. O'FLAHERTY: And the, one of the sentences here, I want to understand what you're saying, it says, because there are many companies providing this information, and due to our remoteness from the individual data elements, you would not, it was not practical for us to put in place direct audit, it says directly, but I guess direct audit, or audit-like procedures. That sentence there, can you tell me what you mean by due to the remoteness of the individual data elements?

MR. PELLY: Our remoteness from the individual data elements, what we're talking about there is we have ... well if we take the number 50 as an example, 50 insurers submitting data to the Insurance Bureau of Canada on a regular basis over a period of time, for us to go to all 50 of those companies and to confirm that the information they're preparing and submitting to the Insurance Bureau of Canada, independent of the work that the Insurance Bureau of Canada already does in that regard, would make this process so slow and so expensive that it, no one would ever do it.

MR. O'FLAHERTY: Okay, that's fair, I was more focusing on the issue of remoteness, what that meant.

MR. PELLY: It just means they're not all, they're not all under the control of Facility Association, they're not all ... they're industry companies but they're not ... I don't have access to all of them, I am remote from them.

MR. O'FLAHERTY: Okay, because I, you know, I was just speculating that perhaps you meant remote geographically from them.

MR. PELLY: I think more in terms of relationship.

MR. O'FLAHERTY: Relationship, okay, so if you look ... I understand your point with respect to the 50 companies, and it's also your position it would be impractical to directly audit the loss experience of the four servicing carriers as well.

MR. PELLY: Well, again, there is actually two tiers of verification, and I'll use that expression rather than audits, that I avoid trying to represent it as being a literal audit. The Insurance Bureau of Canada subjects submissions from the servicing carriers to the same kind of data edit checks that it does the industry data, and in addition to that, Facility Association does have premium and underwriting audit teams that go out and look and examine the processes that the various servicing carriers are using for information generally, the accuracy of it, and that would include the information submitted to the Insurance Bureau of Canada.

MR. O'FLAHERTY: So that's the built in reliability that you rely upon.

MR. PELLY: Basically.

MR. O'FLAHERTY: Okay, thank you. I just want to turn now to the methodology of your report. The filing, it's page four of the filing.

MR. PELLY: Yes.

MR. O'FLAHERTY: We're now in section two which deals with your developing the indications for the average rate level changes for the province.

(1:15 p.m.)

MR. PELLY: Yes.

MR. O'FLAHERTY: Is this methodology completely consistent with the 2001 filing?

MR. PELLY: There have been some development, some evolution to it.

MR. O'FLAHERTY: And what changes have been made in the methodology since 2001?

MR. PELLY: If my memory serves me correctly, we did refine the technique used for estimating the adjustment for rate level changes in calculating unlevel premium, and we did expand the manner in which we recognize premium drift in the analysis. Now that may not be a decipherable explanation, but I think it's complete.

MR. O'FLAHERTY: Okay.

MR. PELLY: If it's important to you I can go into more detail.

MR. O'FLAHERTY: Well, I don't understand the first point, so perhaps it would be useful if you could tell me ... you refine the technique used for ...

MR. PELLY: Previously, when we're developing a rate indication, in order to measure how much of a rate level change that represents, we have to compare it to an estimate of the current rate level. That's a number we have to estimate too, and usually the methods used for making that estimate is to take as recent written premium, average written premium number as you've got, and make adjustments to that to recognize what impact might be expected on that average written premium from previous rate revisions that have been approved and implemented, that haven't fully worked their way through the system yet so that that written premium, that average written premium can be restated to reflect the current rate level, because it hasn't, not enough time has gone by for it to fully reflect the current rate level, so you need to have some kind of a technique for making that estimated adjustment. We refined that technique.

MR. O'FLAHERTY: Alright, and the second change in methodology?

MR. PELLY: The second element had to do with the concept of premium drift that I spoke about briefly yesterday. This is the recognition of change in average premium level that can arise in situations that are evolutionary in the sense that there's a distributional shift through time that appears to have some predictability, some stability, some ongoing feature to it. What we did was we added a consideration of limit drift, so a tendency with over time for people to move towards higher limits of liability, and deductible drift, which again is a tendency for people over time to move to higher deductibles, and all we're doing is recognizing that that's going to have an impact on the average premium too, and we want to try and do the best estimate we can of what the current average premium is at the time when these rates will come into effect.

MR. O'FLAHERTY: I may return to those briefly afterwards, but I just want to understand whether or not this change from the breaking the data down annually and half yearly, is that considered a change in the methodology?

MR. PELLY: It's always difficult to know whether you call that method or not. Arguably, I guess you could say it was. We were just trying to work with the latest data available, and that, philosophically, that's what we always try and do.

MR. O'FLAHERTY: And when you use the ... well, first of all, let me ask you, what's the accepted approach in the Ontario jurisdiction, is it half yearly or annual?

MR. PELLY: I think both are acceptable to the regulator there, but for Facility Association specifically, we primarily rely on accident year data, but we do use accident half year data for purposes of doing trend there.

MR. O'FLAHERTY: And you touched on that in your discussion of trend as well, you're more comfortable with that because of the higher numbers of ...

MR. PELLY: You have a bigger population base, and in an accident half year statistic with that size of a population base, there's, in my view, sufficient stability to use the accident half year data for trending purposes.

MR. O'FLAHERTY: And I understand your point, you're saying in 2001 you were effectively forced to use half yearly analysis because you used the most updated information possible, or you chose to.

MR. PELLY: We pulled it in, not specifically for trend, but for, for loss development and the estimate of the provincial rate level change, yes.

MR. O'FLAHERTY: And did that methodology, and I'll call it that for now, did that allow you to adjust for seasonality?

MR. PELLY: The only ... did it allow us ...

MR. O'FLAHERTY: And let me rephrase the question. As a result of using that approach, did you adjust for seasonality?

MR. PELLY: In the places where we needed to, we did.

MR. O'FLAHERTY: Okay, so then I take it in your opinion then, the use of the half yearly data and adjusting for seasonality was a reasonable approach in 2001?

MR. PELLY: Well, in 2001 the place where we needed to make that adjustment was not in trend, but was rather in the analysis of the provincial rate level requirement, so if you're inferring some relationship back to my previous comments about the use of half year data, it wasn't in the same place.

MR. O'FLAHERTY: Well, I'm not, I'm just ... okay, let me ask you this question then, is it a reasonable approach to use half year data and to adjust for seasonality?

MR. PELLY: In the context of trending?

MR. O'FLAHERTY: Yes.

MR. PELLY: I would recommend against it in Newfoundland and Labrador, only because the experience becomes more volatile as a result of doing so.

MR. O'FLAHERTY: Is this an area in which actuaries can agree to disagree on that particular point?

MR. PELLY: I'd say the evidence is in on that one.

MR. O'FLAHERTY: Okay, so then, again, is it a reasonable approach in Newfoundland ...

MR. PELLY: To use half year data?

MR. O'FLAHERTY: To use half year data, adjusting for seasonality?

MR. PELLY: I think I could probably construct a regression model that would work for it for some of the coverages. I would say for bodily injury, that would be a tough sell, but only because you're dealing with a more volatile type of coverage. For the physical damage coverage, it's more predictable, it's less subject to development, it could be reasonable. I don't think I'd want to say it could be reasonable for bodily injury.

MR. O'FLAHERTY: So it's unreasonable for bodily injury?

MR. PELLY: I guess I would have to undertake the analysis to actually reach that conclusion. I haven't done the analysis to categorically make that statement.

MR. O'FLAHERTY: Well, and I don't want to belabour the point. Is it fair to say then that you believe there's a more appropriate analysis.

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, and the Board, right, and the Board's actuaries' analysis, would you be prepared to concede that it's likely a reasonable analysis but not the analysis that you would think appropriate in this case?

MR. PELLY: Well, as I tried to demonstrate this morning, there are several ... in the specific area of trend, there are several trends that I cannot understand how they came to the conclusion it was a reliable indicator, and those ones that are really far out of line, I'm ... no, I can't consider them to be reasonable.

MR. O'FLAHERTY: But doesn't that bring into a consideration of the regression model used, and the number of years selected and all kinds of factors?

MR. PELLY: Sure it does.

MR. O'FLAHERTY: Right, okay, so I'm just talking about the basic approach of using half yearly data and adjusting for seasonality. I'm not into the ... if you see what I mean, I'm not right in the middle of the analysis now. I know you don't agree with the Board's actuary, I'm asking is the basic approach a reasonable one, even though you don't agree with it?

MR. PELLY: Well, it certainly can be.

MR. O'FLAHERTY: Thank you, and would the change from 2001 when you used half yearly data, to this year's filing, would that have ... when you used annual data, would that have any effect on the loss development factors that you selected?

MR. PELLY: Yes, it would.

MR. O'FLAHERTY: And what effect would that change generally have, if you can answer that, on the indicated rate level changes?

MR. PELLY: It's not predictable. It would just be, there would be new information, you react to the new information, it wouldn't be driven by whether it's half year or whole year data.

MR. O'FLAHERTY: And would the change from half yearly to yearly data have an effect on the loss trends?

MR. PELLY: Once again, we didn't, in the May 2001 filing we didn't use the half year data to fit trends.

MR. O'FLAHERTY: Okay, so you only used it for loss development factors.

MR. PELLY: But we did use it to update the history to which we were fitting the accident year trends, so you have half year data, it allows us to update the experience for the 2000 accident year, or the 1999 accident year, because we have six months more data, but we still work with it as an accident year, so it influenced the trend result but we did not change the basic approach to fitting models, we still fitted the models to the accident year model data.

MR. O'FLAHERTY: Mr. Chairman, I know I've strayed somewhat outside of the methodology section of the report, but I was going to head into loss development, and I think this might be, because it's a brand new topic, and may be a significant topic, an appropriate time that I conclude for the day.

MR. SAUNDERS, PRESIDING CHAIRMAN: Sure, that seems to be in order. We will be resuming at 9:00 in the morning. Okay, thank you ladies and gentlemen.

(hearing adjourned to December 13, 2002)