(9:05 a.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: Good morning. Okay. Are there any preliminary matters, Ms. Newman?

MS. NEWMAN: Yes. I did want to mention for the record that this morning had been originally scheduled as a public participation day, however, in light of the fact that we're still in the middle of actuarial evidence, everyone has agreed, including those who have identified themselves as wishing to participate in this proceeding, to postpone the public participation day to a more convenient date, which will be scheduled likely after Christmas sometime. That's all.

MR. SAUNDERS, PRESIDING CHAIRMAN: That's fine with everybody?

MR. O'FLAHERTY: Fine, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. Where are we with Mr. Pelly this morning? Do you want to resume the stand, Mr. Pelly?

MR. PELLY: Yes.

MR. SAUNDERS, PRESIDING CHAIRMAN: Good morning and welcome back to Newfoundland.

MR. PELLY: Thank you, sir.

MR. SAUNDERS, PRESIDING CHAIRMAN: Something tells me you brought the snow with you this time.

MR. PELLY: I've been accused of that before.

MR. SAUNDERS, PRESIDING CHAIRMAN: Well, we'll see as the day draws on. Okay, Mr. O'Flaherty.

MR. O'FLAHERTY: Thank you, Mr. Chairman. Mr. Chairman, I would estimate that my questioning of Mr. Pelly should conclude in about a half an hour to 40 minutes and the documents that I would be referring Mr. Pelly to during questioning would be the BGP-3, which is the coloured set of charts which have been provided, and as well the Intervenor's pre-filed evidence, which is a blue bound volume. (inaudible)

MR. SAUNDERS, PRESIDING CHAIRMAN: Can't find this one? Right here, on your right.

MR. WHALEN, Q.C.: There's a second copy of the pre-filed evidence ...

MR. O'FLAHERTY: I have pre-filed. I'm just looking for the ...

MR. SAUNDERS, PRESIDING CHAIRMAN: BGP?

MR. O'FLAHERTY: Okay, no. Got it. It's Tuesday morning. This morning, Mr. Chairman, I'll be dealing with a couple of issues concerning commercial loss trends and then turning to what is the final area of my cross-examination. Mr. Pelly, regarding the, what's been described as the intuitive argument for the unemployment variable, I just want to understand again the basic propositions that underlie that argument. As I understood it, you're suggesting to the Board that when times are tough, people in Newfoundland might use their vehicles less for less essential tasks, with the consequence being that there could be correspondingly less exposure and therefore correspondingly less frequency of accidents.

MR. PELLY: That's correct.

MR. O'FLAHERTY: So if we break that argument, that intuitive argument down, I would suggest that there are really two ideas here or two propositions, the first being that unemployed persons would use their vehicles less for less essential tasks, and the second that there is a direct correlation between vehicle usage and frequency of accidents. Would you agree with that?

MR. PELLY: Vehicle usage in the sense of the extent of the usage.

MR. O'FLAHERTY: Yes.

MR. PELLY: I agree. And I should clarify that that intuitive argument applies for certain coverages.

MR. O'FLAHERTY: Yes, exactly. I believe the argument applied to the physical damage coverages in your particular case.

MR. PELLY: Well, for comprehensive it, the intuitive argument is actually in the opposite direction.

MR. O'FLAHERTY: I'm sorry, you're right, it is. Okay. But just so I understand the two propositions, first of all is that unemployed persons would use their vehicles less for less essentials tasks in Newfoundland, and, secondly, that as a more general proposition, I take it, that the less frequency of use, sorry, the less use of a vehicle, the less frequency of accidents that should be manifested.

MR. PELLY: I think that's fair but it wouldn't be limited to just unemployed persons who would use their vehicles less, but ...

MR. O'FLAHERTY: Oh, I agree with you. So the second proposition, would you agree, seems the more fundamental or more broad-ranging proposition of the two?

MR. PELLY: I don't know that I can rank them.

MR. O'FLAHERTY: In any event, I just want to turn to the proposition concerning the use of vehicles by unemployed persons in Newfoundland. Is there any statistical evidence to support that proposition?

MR. PELLY: Not that I have.

MR. O'FLAHERTY: Okay. Now, in terms of the proposition that there is a direct correlation between the frequent, sorry, the use of the vehicle and the frequency of accidents, is that generally accepted to be a reasonable assumption in your field?

MR. PELLY: I've certainly heard it expressed by actuaries other than myself, so I don't know whether I would want to attribute it to generally accepted, but it's not an uncommon foundation.

MR. O'FLAHERTY: Not an uncommon, okay. I mean, it seems reasonable on first blush. But you don't have any statistical evidence, I take it, for the Board to support the first proposition regarding the unemployed persons in Newfoundland and Labrador.

MR. PELLY: No, nor do I seek it. What I'm looking for when I'm doing my trending work is that there's some logical foundation for the conclusions I'm reaching. Common sense does need to prevail. When you're doing this kind of work, there's a lot of judgement involved and it's important to have some thought process behind your conclusions.

MR. O'FLAHERTY: Okay. I just want to turn then briefly to the area of the commercial vehicle loss trends, and these are the charts found at pages 30 and 31 of BGP-3. Well, the first is the chart and the second is an analysis of this particular chart.

MR. PELLY: I have that.

MR. O'FLAHERTY: Now, just to orient the Board back to when we touched on this last week, this is the big area of difference of opinion between your analysis and the Board's actuarial analysis regarding the commercial side of this application.

MR. PELLY: This is the lion's share, yes.

MR. O'FLAHERTY: I believe you estimated it accounts for 15 points of the 17 points.

MR. PELLY: That was Mercer's estimate, yes.

MR. O'FLAHERTY: Well, based on Mercer's estimate, that was your evidence, that it was 15 of the 17 points. That's how you analyzed it as well, would you agree?

MR. PELLY: I didn't do an independent analysis of that. I was relying on the breakdown provided by Mercer in their report.

(9:15 a.m.)

MR. O'FLAHERTY: Fair enough. And is it also true that most of this 15 to 17 points is attributable to the bodily injury issue?

MR. PELLY: I believe that's the case, yes.

MR. O'FLAHERTY: So then we can agree for the purpose of the examination this morning that this is the most important actuarial point for the Board in terms of the commercial vehicle rate decision.

MR. PELLY: I think that's an accurate statement.

MR. O'FLAHERTY: Okay. Now, just referring to the actual chart itself, I just want to orient ourselves with the chart. Does the blue line represent the predicted trend based on your analysis?

MR. PELLY: That's correct.

MR. O'FLAHERTY: And does the green line represent the predicted trend based on the Mercer analysis?

MR. PELLY: Yes, it does.

MR. O'FLAHERTY: And the red line represents the actual historical loss cost data for bodily injury in respect of provincial commercial vehicle third party liability coverage.

MR. PELLY: Bodily injury component and it's on an accident year basis, yes.

MR. O'FLAHERTY: Okay. And basically the loss trends that you've predicted is 11.5 percent.

MR. PELLY: Just give me a second.

MR. O'FLAHERTY: No problem at all.

MR. PELLY: Yes.

MR. O'FLAHERTY: And the Mercer predicted trend is 8.4 percent?

MR. PELLY: Yes.

MR. O'FLAHERTY: And I just want to re-cap then the principles at play here in arriving at the two different regression analyses. Your analyses, sorry, your analysis opts for a longer period of time to increase the stability and Mercer's analysis selects a shorter period of time for responsiveness purposes.

MR. PELLY: Yes.

MR. O'FLAHERTY: So the green line begins in 1994 and moves forward to 2005 and the blue line begins 1989 and moves forward to the same 2005 period, so it's a longer period of time that's involved.

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, thank you. Now, if we take the point at which the Mercer analysis begins, this is the 1994 point where the green, first green dot, I understand that their regression analysis is analysing the trend using the same historical data as you do, that is up to the end of 2001.

MR. PELLY: Other than the fact that they analyze accident half year data and we're analysing accident year data and they are excluding certain data points and we are excluding certain data points and we're not excluding the data points always because we've got a different body of data.

MR. O'FLAHERTY: Sure, no problem. And those were some points I was, I would have brought those up. But in basic terms we're both dealing with 1994 through to 2001 AIX information, in terms of just the general time frame that the two lines follow at that time.

MR. PELLY: Well, I believe we're both using 2000, 2001 AIX data.

MR. O'FLAHERTY: Right, okay. And one of the differences is that the Mercer analysis uses twice as many data sets over that period of time, that is they use half year accident data.

MR. PELLY: Yes, okay.

MR. O'FLAHERTY: Now, your chart here does not show the half yearly data points on the chart, does it?

MR. PELLY: No, it does not.

MR. O'FLAHERTY: Is there any reason why you haven't shown those on the chart?

MR. PELLY: Just trying to avoid clutter.

MR. O'FLAHERTY: Okay. Now, can we agree that the point on the graph that is excluded by your analysis is the 1998 red point below both the green and the blue line? I notice also the 1993 point is excluded as well, the high one. I just want to deal with the period of time from 1994 forward.

MR. PELLY: That's correct.

MR. O'FLAHERTY: And what is the difference in value between ... this is an outlier, I take it, this point, the red point?

MR. PELLY: Yes.

MR. O'FLAHERTY: And what is the difference in value between the red point and the blue line just above it?

MR. PELLY: I'm going to have to estimate that from the graph, I'm afraid ...

MR. O'FLAHERTY: Sure.

MR. PELLY: ... because my chart doesn't have that, my file doesn't have that.

MR. O'FLAHERTY: Can I suggest to you it looks like it's about 100 points on the loss cost ...

MR. PELLY: In the neighbourhood of $100, yes.

MR. O'FLAHERTY: In the neighbourhood of $100. Now, as you've indicated, we don't have the half yearly data points marked but can we agree that the outliers which have been identified by the Mercer analysis are the, are in the area above the 2000 year markers, sorry, year point on the horizontal graph?

MR. PELLY: They excluded four half year data points.

MR. O'FLAHERTY: Okay. So we don't have those marked but where is the area that they have excluded from their particular analysis?

MR. PELLY: They excluded the first half of 1996, the first half of 1998, the second half of 2000 and the first half of 2001.

MR. O'FLAHERTY: Okay. I want to focus on the 2000 and 2001 exclusions, okay?

MR. PELLY: Okay.

MR. O'FLAHERTY: Where are those located on the chart?

MR. PELLY: Well, they're not shown. They're historically the second half of 2000 and the first half of 2001.

MR. O'FLAHERTY: Right. Can we identify the area on the chart where they would be excluded from on that red line of actual historical data?

MR. PELLY: Well, I guess conceptually it's a little to the right of the 2000 vertical line, it would be the second half of 2000, and a little to the left of the 2001 vertical line would be the first half of 2001.

MR. O'FLAHERTY: Okay. Now, it's more difficult there to estimate the difference in value between the green line and the outliers there, isn't it?

MR. PELLY: Well, again they were analysing accident half year data so it's given, assuming that their logic for making the exclusions was based on the accident half year data. I really can't comment on it from this chart.

MR. O'FLAHERTY: Okay. Would you agree that the outliers that are excluded by Mercer's Report are further from the predicted trend line than the 1998 points that have been excluded, sorry, the 1998 points excluded by Eckler from their trend line in terms of absolute value?

MR. PELLY: I wouldn't have any idea. I don't know.

MR. O'FLAHERTY: Okay. Just looking at the chart, it appears that the points, the red points, which are shown between 2000 and 2001, okay ... do you see those?

MR. PELLY: Yes.

MR. O'FLAHERTY: Those dots that you've drawn ... unfortunately we don't have the half year data but it appears as if those are greater than the 100 value that you've just indicated for the 1998 data. Would you agree with that?

MR. PELLY: Well, the comparison is invalid but, yes, I agree, it's more than $100.

MR. O'FLAHERTY: You're satisfied it is more than $100 on the chart or you're satisfied it's more than $100 ...

MR. PELLY: Well, if you're asking if the red data point on the chart for 2000 is farther away from the corresponding green data point, then $100, I would agree, but ...

MR. O'FLAHERTY: But we don't have the half year data points marked, so it's not a question that you can answer definitively, I take it?

MR. PELLY: Well, you're trying to draw an analogy with the 100 and I don't think that that analogy holds given the comparison that you're making on the 2000 data point or the 2001 ...

MR. O'FLAHERTY: Correct, and perhaps that's one of the difficulties with the graph as it's shown, but the main point is, what I'm trying to establish is, are the outliers that have been identified by Mercer's with respect to their regression trend line, do they have a higher value than the outlier identified by Eckler Partners Limited in 1998 from their regression trend line?

MR. PELLY: I'm not in a position to be able to answer that question.

MR. O'FLAHERTY: Okay, thank you. Now, on the next page you show the results of your testing of these two alternate regressions and I believe that you stated that these are both strong performing regressions. Would you agree with that statement?

MR. PELLY: Well, in terms of the R bar squared I would. There's some question with respect to the seasonality variable, the validity, the contribution that that variable is making to the overall regression.

MR. O'FLAHERTY: And I believe that you've indicated as well that those are both a pretty significant fit for statistics in the R bar squares. Would you agree with that?

MR. PELLY: I would.

MR. O'FLAHERTY: So these are both pretty good values.

MR. PELLY: There's just the question of whether or not ... I mean, one should test to make sure that the seasonality variable isn't distorting the outcome of the regression, so you'd want to look at that to see if the exclusion of the seasonality variable improves the quality of the performance.

MR. O'FLAHERTY: With all things being equal, would you agree that these are both fairly good regression models to demonstrate how the trend would, can be drawn from this particular data?

MR. PELLY: With the relative data bodies of history used in each, but there are data points of course excluded from one that are not excluded from the other, so you need to factor that into your consideration when you're comparing the two models.

MR. O'FLAHERTY: Oh, correct, yes, for sure. Okay. Now, one of the ... I'm going to get now to the, I guess really the, one of the issues I want to talk to you about. When you compare the trend analysis for commercial, for the commercial trend for the 2000 and 2001 winter, that is the Mercer trend analysis for private passenger vehicle, you questioned whether this particular commercial trend made intuitive sense to you, the exclusion, that is, of the data from the 2000-2 and 2001-1 accident sets, isn't that correct?

MR. PELLY: The accident half year data points, I questioned why they needed to be excluded.

MR. O'FLAHERTY: And the basis of your, certainly the intuitive basis of questioning that was that you seemed to indicate that the same pattern wasn't demonstrated on the private passenger side when they analyzed the half yearly data for that winter.

MR. PELLY: From Mercer's own analysis they did not exclude those data points.

MR. O'FLAHERTY: Fine. I believe you said that because Mercer's report did not identify this aberration, this called into question in your mind the validity of excluding these two data points from the commercial trend analysis. Is that a fair statement?

MR. PELLY: Well, there might have been an intervening step or two in the logic transfer but basically ...

MR. O'FLAHERTY: Okay. Well, I'm going to suggest to the Board, and that's why I want to give you an opportunity to respond to this, that there's an intuitive explanation which is based on an evidentiary foundation this time for the lack of the correlation between these two trend analyses, and I take it from your evidence that you'll accept that the weather was very severe in 2000, in the winter of 2000 and 2001.

MR. PELLY: I recall storms, yes.

MR. O'FLAHERTY: Okay. Have you had an opportunity to review the Intervenor's pre-filed evidence concerning that point?

MR. PELLY: No, I haven't seen it.

MR. O'FLAHERTY: Okay. Well, I'm not going to ask you to read through it but there is evidence which is not proved before the Board at this stage but will be called from Environment Canada to the effect that the conditions that winter were unlike any other winter in living memory, okay, so I want you to assume that for the purpose of my questions this morning.

MR. PELLY: Okay.

MR. O'FLAHERTY: Okay. And specifically that the snowfall was about three times the normal levels, okay? That there was lower rainfall and generally colder temperatures and there were much more frequent snowfalls than in a normal winter, okay, so there wasn't a number of large snowfalls, there was many more moderate snowfalls during that winter, okay?

MR. PELLY: Okay.

MR. O'FLAHERTY: The evidence will also show that there were a much more frequent experience of closure of schools and businesses during that winter, okay?

MR. PELLY: Okay.

MR. O'FLAHERTY: And also that there was an increase in reported accidents to the RNC, that is the policing body that polices in this particular area, mostly in Territory 1 for these purposes, okay?

MR. PELLY: Okay.

MR. O'FLAHERTY: Now, assuming that this evidence is accepted by the Board, would you agree that intuitively the likely combined effect of these factors would be a lower use of private passenger vehicles, of private passenger vehicle traffic on the roads during that period of time?

MR. PELLY: I guess that's a possible outcome.

MR. O'FLAHERTY: Okay. Now, take two winters, one which has this pattern which is this unusual weather pattern in which there is three times the snowfall, our schools are closed and businesses are closed, okay, and there are a lot of accidents being reported. Would you not agree that it's reasonable to conclude that there would be a corresponding lower use of private passenger vehicles in the severe winter as opposed to the normal winter?

MR. PELLY: I think I just answered that question.

MR. O'FLAHERTY: Okay. You're prepared to accept that, okay. And would you also agree that principal operators of commercial vehicles do not have the same ability to vary their usage patterns as do private passenger vehicle principal operators?

MR. PELLY: Well, other than the fact that you've just said that businesses were closed, so if the businesses were closed there'd be lesser use of commercial vehicles as well.

(9:30 a.m.)

MR. O'FLAHERTY: Okay. The bread has got to be delivered, right, and the oil trucks have got to be on the road regardless, don't they?

MR. PELLY: And some private passenger vehicles have to be on the road too, yeah.

MR. O'FLAHERTY: Now, we earlier agreed that, I believe at least, that there is a correlation between lower vehicle use and the lower frequency of accidents as a general proposition, didn't we?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay. Now, doesn't this explain then intuitively why there might not, you might not have seen the same trend difference between the previous winter for private passenger vehicle as you would have seen with the commercial vehicle, private passenger, sorry, commercial vehicle analysis for trend purposes?

MR. PELLY: Well, I hear your argument. I don't know that I can observe it in the data but ...

MR. O'FLAHERTY: Well, I want to give you an opportunity to respond to it, that's all, Mr. Pelly. I mean, I just want to hear, you know, intuitively that's ...

MR. PELLY: No, I don't follow the intuitive argument distinguishing between private passenger and commercial.

MR. O'FLAHERTY: Okay. And is there any particular reason why you do not?

MR. PELLY: I don't fathom it, I don't comprehend it.

MR. O'FLAHERTY: I believe your evidence, and I'm going to paraphrase it on the point, was that you didn't think it was reasonable for the Mercer analysis to find these points as outliers because the same storms that were being, occurred, must have had the same effect on private passenger vehicles as they did on commercial vehicles.

MR. PELLY: The same effect might be an overstatement but I think you would expect to see some kind of a pattern change evident in the private passenger experience as you would in the commercial experience. The other basis for our decision to make the exclusion was on the basis of the analysis of the data points themselves. We have an objective outlier test and the objective outlier test did not point out the winter 2000/2001 data points as being outliers in the commercial vehicle bodily injury trend analysis.

MR. O'FLAHERTY: Okay. But we were dealing with this intuitive argument and I just wanted to get your response to it. So in your view then, that you don't follow the logic of that particular intuitive explanation or argument.

MR. PELLY: Well, it's all a question of relative weights and I don't think I can jump to the conclusion that, because there may be a commercial vehicle that has to be on the road, it would necessarily have, lead to stronger prevalence of impact from the winter storms for commercial vehicles than would otherwise be the case for private passenger vehicles.

MR. O'FLAHERTY: Okay.

MR. PELLY: Because I'm sure there are private passengers that have to be on the road too. There are people who have to get to work, that work at hospitals or ...

MR. O'FLAHERTY: Okay. And I'll finish up now, a couple of more questions. Yet even though I've indicated that we will call evidence on all these points, you're prepared to accept the proposition as logical that persons in Newfoundland and Labrador who are unemployed use their vehicles less with no statistical or evidentiary foundation, yet you're not prepared to accept the logic of this other proposition or intuitive argument that I've presented regarding commercial vehicles.

MR. PELLY: Well, my position isn't predicated on accepting or rejecting that intuitive argument. It's simply we make a regression, we make an observation and we seek an intuitive explanation for it. We don't create the position based on the intuitive argument. So you're kind of putting the cart before the horse. And the argument about less usage isn't limited to just unemployed persons, it's an intuitive argument for just the driving population as a whole.

MR. O'FLAHERTY: Okay, thank you very much. I'm going to turn now to the last topic, and I want to talk to you about measuring the relative reliability of FA's previous loss estimates of loss costs in this particular jurisdiction. I'm going to refer you to, and perhaps I can refer the Board and Mr. Stamp, Mr. Whalen, to the evidence of Winston Morris, which is found in, and these aren't numerically tabbed, they're tabbed in terms of alphabetical order in the blue volume called Intervenor's Pre-Filed Evidence. Now, Mr. Pelly, can we agree that the actuary's objective in the exercise that you're undertaking regarding developing the indicated rates is to arrive at a reliable expectation or estimate of FA's future ultimate incurred costs, loss costs in this province?

MR. PELLY: That sounds fair.

MR. O'FLAHERTY: Now, can we also agree that FA has consistently directed its actuarial consultants to make no provision for profit in arriving at indicated rate level changes in this province?

MR. PELLY: That has been the history.

MR. O'FLAHERTY: And indeed that's the history in all jurisdictions in Canada, I believe.

MR. PELLY: To date.

MR. O'FLAHERTY: Okay. Now, I just want to refer you to an exhibit here. I don't know if you've had an opportunity to see this. This is tabbed at number four. This is headed up, "Facility Association Residual Market, Summary of Financial Results." Have you seen this document before?

MR. PELLY: I think I have had it passed before me, so that must mean I have a passing familiarity with it.

MR. O'FLAHERTY: Okay. So in preparation for the hearing you've at least skimmed the document, we'll say.

MR. PELLY: Fair enough.

MR. O'FLAHERTY: Can we agree that the amount of profits that FA has generated for its member companies in this jurisdiction compared to the total premium volume written can give the Board a sense of how good the track record of FA's actuarial consultants have been since inception in Newfoundland and Labrador?

MR. PELLY: When properly measured, yes.

MR. O'FLAHERTY: When properly measured, okay. To your knowledge has your client relied on this same type of analysis to support your track record in other jurisdictions?

MR. PELLY: I've seen an exhibit that Facility Association has, that has been prepared that has some similarities to this, at least the top portion, yes.

MR. O'FLAHERTY: As recently as last month you may have seen an exhibit in Nova Scotia, for example.

MR. PELLY: For example.

MR. O'FLAHERTY: Right. And that exhibit was an analysis based on the net premiums that were written in Nova Scotia and what the returns were to the company in that particular jurisdiction, to the companies in that particular jurisdiction, wasn't it?

MR. PELLY: I think it encompassed disbursements and assessments, yes.

MR. O'FLAHERTY: Okay. But the point of the document was to show that your actuarial, sorry, that the actuarial consultant's expertise in that province had produced a certain result which was quite close to a break even level, is that correct?

MR. PELLY: I don't ... I can't comment on what the purpose of the exhibit was. I mean, I was in attendance. I think the purpose was to demonstrate the cumulative operating results of Facility Association.

MR. O'FLAHERTY: Okay. Well, do you recall this statement, "And our members, after 20 years in business, are $6.3 million to the good on $360 million, so I think as much as anything that's a tribute to our actuaries and this Board. Given the prospective (phonetic) nature of the pricing involved in insurance, I think we've got a pretty good track record since inception in the province." Does that sound like what was said when you were there?

MR. PELLY: That could well be.

MR. O'FLAHERTY: Okay. So the basic point was that in Nova Scotia we're comparing a certain level of return to a certain level of premium volume. So you'll accept then that this can be an adequate measure in this particular province as well using the same type of analysis.

MR. PELLY: Were the profit calculation to be done in a comparable manner, yes.

MR. O'FLAHERTY: Okay. Now, have you had an opportunity, and I know I've asked you if you've seen the document, have you had an opportunity to review the figures that were provided by the Superintendent of Insurance in this particular exhibit?

MR. PELLY: Not really.

MR. O'FLAHERTY: Okay, alright. Well then I'm going to ask you then to assume that they're accurate, okay, for the purposes of my questions. Can you provide the Board with any idea as to whether or not your particular level of, sorry, and I don't mean this in a personal way, your, I mean, the level of actuarial consultant reliability in this province, how it relates to that in Nova Scotia? Can you answer that or should I ask your client about that?

MR. PELLY: I'm probably not ideally positioned to respond to that but as a general observation the magnitude of the cumulative difference between revenues and costs over the lifespan of Facility Association in Newfoundland is of an order of magnitude that is not all that different than an operating result in a single year, so it's, it can disappear or it can reappear fairly easily. It's my understanding that in the current fiscal year the operating results to the end of September are something like $5.7 million to the negative. That takes a big chunk out of what we have here and that's just illustrative of how quickly any kind of cumulative surplus of this order of magnitude can disappear.

MR. O'FLAHERTY: And I think I'm getting the sense that you haven't, you're not in a position to really address the comparison between the two jurisdictions, and that's fair. I just wanted to give you the opportunity to respond to it if you were, but I will take that up with your client, who prepared the other exhibit. I believe that's the last questions I have for Mr. Pelly. Thank you for your patience, Mr. Pelly.

MR. PELLY: Thank you.

MR. O'FLAHERTY: Thank you, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: Thank you, Mr. O'Flaherty. We go next to rebuttal or to redirect or do we go with Board questions?

MS. NEWMAN: Board questions.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, because from hearing to hearing that seems to change.

MS. NEWMAN: Unless anybody has any objections, I would propose to go before the redirect.

MR. SAUNDERS, PRESIDING CHAIRMAN: Then there will be questions arising from anything the Board may bring forward.

MS. NEWMAN: Well, after my questions I would suggest there'd be a redirect opportunity to counsel and then the Board questions and then all the counsel would have an opportunity to address matters arising from the Board questions.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. So are you going next?

MS. NEWMAN: I will go now, yes.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, fine. Let's do that.

MS. NEWMAN: Good morning, Mr. Pelly ...

MR. PELLY: Good morning.

MS. NEWMAN: ... now that we have that straightened out. I have questions in four broad topic areas, which will probably be fairly obvious to everyone here by now, loss development I'll start with, loss trends, some implementation issues and some miscellaneous issues mainly dealing with testimony that you've given to date. I'll start with the loss development, given that we're fresh and this is rather a complex area. Hopefully we'll make most of the way through this by break time at 10:30. I understand from the testimony you've given so far that the loss development differences between you and, or Eckler Partners and Mercer account for the most significant rate impacts or rate indication differentials with respect to private passenger, is that correct?

MR. PELLY: That was Mercer's estimate, yes.

MS. NEWMAN: And you don't take any issue with that estimate?

MR. PELLY: No. I haven't verified it but it seems reasonable.

MS. NEWMAN: Seems reasonable, okay. And with respect to the loss development, I understand that there are two major areas of difference between the report prepared by Eckler Partners and the Mercer Report, first of which is that Eckler used a straight or an arithmetic average and Mercer used a weighted average. Is that correct?

MR. PELLY: Yes.

MS. NEWMAN: And the second of which is that Mercer did not exclude any data points in the use of its straight average whereas Eckler did exclude certain data points in the use of its straight average.

MR. PELLY: I think in the former one you mentioned ...

MS. NEWMAN: Weighted, sorry, yes.

MR. PELLY: ... saying their use of weighted average, and, yes.

MS. NEWMAN: Yes. But there was data exclusions in the Eckler Report but not in the Mercer.

MR. PELLY: That's my understanding.

MS. NEWMAN: So, we'll first deal with the issue of the weighted average and then we'll move on to the data point exclusions. Just to clarify the difference between the two averages, a straight average, I understand, is an average that takes the number of data points, or here the number of years, and divides it, divides the volume, the total volume by those number of years. Is that an accurate reflection of straight average or an arithmetic average? So if you take a number and you have five data points or five years, you'll divide the number by the five and you'll get 20 percent allocated to each particular data point.

MR. PELLY: Yes.

MS. NEWMAN: Whereas in Mercer's weighted average, they allocated a weight to a particular data point based upon the volume that was in that, was associated with that dollar amount or ... is that accurate?

MR. PELLY: In this case I think it's the loss volume but ...

MS. NEWMAN: The loss volume?

MR. PELLY: Yes, it's my understanding.

MS. NEWMAN: We're talking about dollars here when we're talking about loss volume. We're not talking about number of accidents frequency or ...

MR. PELLY: Right, correct.

(9:45 a.m.)

MS. NEWMAN: Alright. Is it fairly common for actuaries to use a weighted average?

MR. PELLY: It's not uncommon.

MS. NEWMAN: Okay. And have you ever used a weighted average?

MR. PELLY: I have.

MS. NEWMAN: And so it's reasonable to use a weighted average in appropriate circumstances.

MR. PELLY: Certainly.

MS. NEWMAN: And it's also reasonable to use a straight average, in your opinion ...

MR. PELLY: Yes.

MS. NEWMAN: ... in the appropriate circumstances. I understand from your testimony last week that one of the reasons, if not the major reason, that you adopted a straight average here rather than weighted average was that you thought it was more appropriate because we've entered a period of declining volume. I have a quote here from December 12th and I'll just read it out to you, so I'll refresh your memory. "One of the consequences of using 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 a general expectation. So the decision to move to a weighted average in an environment where you have 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 claim environment, is that you're choosing to put less emphasis on the more harsh claims environment that we are experiencing in the insurance industry today." So I interpret that to mean that you decided to use a straight average in this instance because, as a result of the declining FA volume of business. The straight average would produce a more responsive result. Is that a fair interpretation of that statement?

MR. PELLY: I would say that the decision to go with a straight average was more predicated on seeking consistency with our approach used for financial reporting purposes. The opening words from the quote that you just read was an observation of the consequence of using a weighted average as opposed to a straight average, so I hesitate to say that the reason we used a straight average was everything you've just said, but rather it was an observation of the consequence of using a weighted average.

MS. NEWMAN: So I guess there's two things there, one is that it was chosen to be consistent with your financial reporting approach, is that what you said?

MR. PELLY: Yes.

MS. NEWMAN: Okay. And we have already highlighted the differences between those approaches in your earlier testimony, I believe. There's many differences between the approach taken in the financial reporting as compared to the rate establish ...

MR. PELLY: Well, there are many differences in terms of the data structure.

MS. NEWMAN: Right.

MR. PELLY: But the general approach with respect to the focus on or balancing between responsiveness and stability, the choice of whether you're using provincial or regional data, those kinds of things are done on a generally consistent basis between the two environments.

MS. NEWMAN: So in the second part of your statement is that it's an observation that a weighted average will give less emphasis to more recent years in a period of declining volume. So you've observed that as to be the case in this circumstance. Are you suggesting that that's the reason that the weighted average is less appropriate or the straight is more appropriate in your mind?

MR. PELLY: Well, in the particular environment that we have here in Newfoundland and other Atlantic jurisdictions, there has been a harsher claims environment, a more aggressive claims environment evidenced in the latest period, the latest years than was the case in the earlier years, so all I'm making is an observation that the consequence of moving to a weighted average is to naturally put less weight on the harsher claims environment. I'm not citing that as a rationale for the basis for our decision to use a straight average ...

MS. NEWMAN: Right, I understand.

MR. PELLY: ... but rather it's just an observation ...

MS. NEWMAN: An observation.

MR. PELLY: ... of the consequence of choosing to use a weighted average.

MS. NEWMAN: So you're suggesting that the weighted average in this instance puts less weight on the more recent years.

MR. PELLY: As a general expectation, that would be the case. Now, if you do specific calculations using the actual dollar values of the loss amounts in an individual development interval, that won't necessarily always be the case because claims don't always come out as expected. That's one of the joys of doing actuarial work. But the basic thrust, the expectation of using a weighted average in an environment of declining claims, sorry, overall exposure, is that you will be placing less emphasis on the more recent claims experience, and in the current environment, the consequence of doing that is to give less recognition to the current reality.

MS. NEWMAN: Perhaps we can actually look to the numbers and you can express how that applies in this circumstance. Looking at Appendix A to the Eckler Report to the filing, page 44, that's Appendix A, page 44, the top triangle there.

MR. PELLY: I have that.

MS. NEWMAN: Am I correct in saying that the numbers in that top triangle would form the basis for the weighting that was done by Mercer in its report?

MR. PELLY: Yes.

MS. NEWMAN: So I'm looking at the column under 12, which is the first numerical column there after the year, and it appears to me that there's larger volume or higher loss costs in the more recent years.

MR. PELLY: That's a reflection ... I mean, take that into consideration in conjunction with the fact that the number of vehicles is declining during the same period of time. That shows you that the dollar amount of losses being reported at, say, 12 months of development, is growing in proportion to the number of vehicles, so the dollars of reported losses per vehicle is actually increasing noticeably, and that's that harsher claims environment that I was referring to.

MS. NEWMAN: Right. But wouldn't the weighted average calculated by Mercer give more weight to this more recent year on the basis that the number is higher than in the older years?

MR. PELLY: In this particular instance that's a true statement and that's what I was getting at when I was saying as a general expectation in an environment of declining exposures or declining volume you run the risk of not being as responsive to the latest experience.

MS. NEWMAN: Right, but that's not the case here in this column.

MR. PELLY: In this particular column because you have dollar amounts that are increasing as you go down the column, that won't be the case.

MS. NEWMAN: Right. So the five year weighted average would be more responsive in this particular instance.

MR. PELLY: Well, if you, for example, if you look to the bottom of the page, the five year weighted, sorry, it uses a lot of short forms here, but there's a WTD 5 YR, which is intended to stand for weighted five year. You can see a value of 1.2016 appearing in the 12 to 24 month interval compared to a value of 1.1911 in the last five year row, and obviously the weighted average value in this instance is higher than the five year average value, and if you look at the actual development factors appearing in the triangle immediately above all those averages, you can see that generally speaking the more recent values are higher than the earlier values over the last several years, so, yes, the observation is that the weighted average is producing a higher value in this instance.

MS. NEWMAN: Similarly in the column 24, the latest year is the highest year, and then we have a generally declining value though that the oldest year is high again, and if we do run the same analysis that you just did comparing the average, the last five year average, which is 1.1107, to the weighted all year, it appears as though the weighted average would be slightly more responsive in this case as well. Is that accurate?

MR. PELLY: Well, I think you want to do it against the weighted five year, which is the 1.1055.

MS. NEWMAN: Right.

MR. PELLY: So it's slightly below the five year average.

MS. NEWMAN: Slightly below but marginally different.

MR. PELLY: Well, it's lower.

MS. NEWMAN: So in the first instance in column 12 it was more responsive, the weighted average was more responsive, and in the second column, 24, would you be able to say which was more responsive there or is it ...

MR. PELLY: Given the pattern in the recent past, it's difficult to say what you're responding to. I mean, look at the last five values appearing in the 24 to 36 month interval, ranges from a low value of .91 at the oldest data point to a high value of 1.21 at the middle of the five years, so you don't have a pattern of increasing or declining factors. You've got fluctuations within the history.

MS. NEWMAN: But we're looking at the volumes up above. We're talking here only about the weights that are assigned and trying to determine which would be a more responsive average ...

MR. PELLY: Yes.

MS. NEWMAN: ... so I'm only looking to the numbers up above here to see in terms of your comment that we have a declining volume making the weighted average less appropriate and less responsive.

MR. PELLY: Well, let's go to the Mercer Report then on page six, on the top half of that page there's a table that's labelled, "Private Passenger Automobiles."

MS. NEWMAN: Yes.

MR. PELLY: There's a column labelled, "Written Vehicles," with an entry to the left-hand side, it's labelled "FA" for Facility Association, and there's a five year history of written vehicles or written exposures, and this is information taken from Facility Association's 2001 AIX and you can see from this history that over the period from 1997 to 2000, this was a period of declining volume with a slight rebound, the beginning of a rebound, which is continuing into the current period starting in 2001. So if you're questioning if there's been a decline in volume, I think that's the evidence.

MS. NEWMAN: Well, what we're talking about here actually is the averages, the weighted versus the straight, so perhaps you can explain to me, I thought we agreed initially that the weighted average is based upon the numbers in that top triangle there.

MR. PELLY: Yes, it is.

MS. NEWMAN: It's not based on these volumes that are set out on page six of Mercer's Report.

MR. PELLY: That's correct.

MS. NEWMAN: Okay. So we can really restrict our, if we're talking about the averages, we can restrict our view to these numbers in the top triangle, because that's what the weight is based upon.

MR. PELLY: Well, the danger of always referring to that as volume is that volume of losses is not the usual interpretation of the expression "Volume."

MS. NEWMAN: But in this case it is because this is the number that was used by Mercer to weight its loss.

MR. PELLY: I'm just seeking clarity. Yes.

MS. NEWMAN: Yes?

MR. PELLY: That's my understanding, they used dollars of losses. This is a typical manner for which one calculates weighted average development factors.

MS. NEWMAN: So we don't need to look to the declining volumes set out on page six.

MR. PELLY: Not for the purposes of this calculation.

MS. NEWMAN: That's where we are, right here with the straight average and the weighted average, so ... so in column 12 we saw that it was actually an increasing ... will we call that loss costs? Is that a ... I don't want to get my terminology ... in column 12 ...

MR. PELLY: Probably just losses.

MS. NEWMAN: Losses, okay. Increasing losses making what we both agreed, I think, the weighted average more responsive in that instance.

MR. PELLY: Yes.

MS. NEWMAN: Okay. And in the second column, 24, we had variability there and it was hard to determine whether there was, which of the two averages would be more responsive. Is that fair?

MR. PELLY: It's fair because in order to seek responsiveness you need to have a pattern of change through time so that there's something to be responsive to. If all you've got is randomness in the history, then there's really nothing to be responsive to.

MS. NEWMAN: So I guess the point I want to make here is that at times, and in particular here, the weighted average can be more responsive than the straight average and it is in fact for this particular one column more responsive than the straight average.

MR. PELLY: That seems to be the outcome.

MS. NEWMAN: And is it true to say that if you wanted to use, to have your data the most responsive you would vary the average that you use for each of these particular columns so that you knew that in column 12 the weighted average was more responsive, so you use a weighted average and then you go on to column 24 and you can decide whether it was the weighted or the straight that you would use and so on until the last calculation. That would give you the most responsiveness.

(10:00 a.m.)

MR. PELLY: I suppose the ultimate in responsiveness is just to take the last development factor and assume it applies for the next rating period, but ...

MS. NEWMAN: Okay. So I gather you wouldn't want to do that. You wouldn't want to take a difference average for each of those columns, would you?

MR. PELLY: That's not beyond the realm of possibility. I've seen that work done by actuaries where they've chosen a different basis for averages in successive intervals so it's not unheard of.

MS. NEWMAN: But you didn't ...

MR. PELLY: Personally, I probably wouldn't do that, no.

MS. NEWMAN: Why not?

MR. PELLY: I find it, if you're going to adopt a philosophy for, as a starting point for making your factor selections, it seems to me to be more consistent to adopt a basic philosophy for application for a particular coverage and then deviate from it as the actual experience itself demonstrates to you for, as a need to deviate from that basic starting point, so I think Mr. O'Flaherty referred to it as a default approach, so if you start with a default approach and then vary from that, it probably brings more consistency to your work or that would be a hopeful objective of bringing more consistency to your work.

MS. NEWMAN: Those are all my questions on the weighted average section of the loss development. I'd like to now move on to the even more convoluted part of this line of questioning, which is the exclusion of the data points. Hopefully we'll get through this by break and it should all flow a little easier after that. My questions on this point will hopefully follow along those put to you by the Consumer Advocate and hopefully there won't be too much redundancy but they will serve to bring some more clarity to this complex issue. I wonder if I can set out a basic statement of what I view as what we've heard to date, and then you can clarify it where it's wrong or doesn't go far enough or goes too far. Based on what you've said to date, would it be fair to say that in determining your straight average for private passenger bodily injury and property damage, as well as commercial bodily injury and property damage, that you excluded points which you felt to be outliers?

MR. PELLY: Yes.

MS. NEWMAN: And that is, at all times in excluding the points, that was the test whether they were outliers?

MR. PELLY: Well, we were seeking to select an assumption which we intended to be appropriate for future, for application in a future or a prospective sense, so we were looking to make a reasonable assumption or establish a basis of reasonable expectation for prospective application.

MS. NEWMAN: And I think you've defined an outlier earlier as one which is not characteristic of what you expect in the future, so that would be consistent with what you just said.

MR. PELLY: That's what we're trying to do.

MS. NEWMAN: Okay. In each case, without going to the numbers you'll probably be able to answer this, in each case of excluded point, I think it's fair to say that they were the lowest number in each body of figures or in each coverage, is that, for each data point, is that fair to say?

MR. PELLY: Certainly among the lowest. If you're referring to the five year history, then it was ...

MS. NEWMAN: Yes.

MR. PELLY: ... probably the lowest. If you're referring to the all time history, I believe the cases where we made exclusions were very close to being the lowest, if not, but there wasn't a lot of historical support for a value being that extreme.

MS. NEWMAN: So in every case the exclusion was, the exclusion or exclusions were the lowest or the two lowest of these set of numbers that we were looking at.

MR. PELLY: Within the five year history?

MS. NEWMAN: Yes.

MR. PELLY: I believe that's the case, yes.

MS. NEWMAN: And is it correct to say that your exclusions had the effect of increasing the average?

MR. PELLY: In this instance, yes, but, I mean, that's because they were the lowest values.

MS. NEWMAN: And therefore that would increase the rate indications.

MR. PELLY: True.

MS. NEWMAN: We're on page 44 so that's where we're going to start with this. I'm looking at the second triangle, just in the middle of the page there, in the first column, 24/12, and the Consumer Advocate asked you some questions on this column last year and in particular the last data point, which is 1.4106, which is quite a bit higher than the others.

MR. PELLY: Yes.

MS. NEWMAN: And I believe you said, you can correct me if I'm paraphrasing you incorrectly, I believe you said that the reason that you didn't exclude this data point was that you felt there was increased variability in this particular column because it's most recent data. Is that a correct paraphrasing of what you said?

MR. PELLY: Pretty close. Well, it may be an accurate paraphrase. I'm not sure what exactly I said, but the premise is that in the early development intervals, the magnitude of development factors will typically be larger and there will typically be more volatility in those numbers just by virtue of their bigger size. The value of 1.4106, given the history that's evident from the full column, doesn't stand out as being without, doesn't stand out as being extreme compared to the history.

MS. NEWMAN: So you had said that you looked to the history prior to the five years and you found, for example, in 1994, there's one data point there that's 1.4652.

MR. PELLY: For example, yeah.

MS. NEWMAN: And then in 1991 there's a data point that's 1.4989.

MR. PELLY: Yes.

MS. NEWMAN: So I take it that you feel it's appropriate to consider these relatively old factors, and I take that as a perception on my part, but these factors which are dated, I guess would be fair to say, from 1994 and 1991 to be relevant for selecting your loss development factors to apply to 2001. Is that fair to say?

MR. PELLY: We consider the whole history but we're, the default approach that we're looking at is responding to the experience in the last five years. When we're assessing the characteristics of the individual data points that are provided in the last five year period, we do consider the whole history.

MS. NEWMAN: Okay. But would it be reasonable for another actuary to not look to exclude this 1.4106 on the basis that in the last five years there was nothing coming near that number and not consider the old data in 1991 and '94 as being relevant? Would it be reasonable for an actuary to exclude that? It's a matter of judgement, isn't it?

MR. PELLY: Well, it's a matter of judgement. I think given the history I would find that unusual but if the triangle was truncated so that you didn't have the older history and all you had was the last five points in each column as you went across, and I was presented with only five years of data, then I would probably find the 1.41 to be an unusual value given that, but when I have a history, I take advantage of it being there.

MS. NEWMAN: And if you have excluded the 1.4106, that would have had the effect of lowering the average and lowering the rate indication. Is that true?

MR. PELLY: Yes, that's correct.

MS. NEWMAN: The next column that I'd like to look at is the 36/24 column.

MR. PELLY: Yes.

MS. NEWMAN: I believe that you excluded the number for 1995 there, which is .9110. Is that correct?

MR. PELLY: Yes.

MS. NEWMAN: I presume that you determined that that also was an outlier?

MR. PELLY: Yes.

MS. NEWMAN: Now, I'm looking to the older history here and I note that there are a couple of data points where there are numbers below one, similar to this number. Did you consider those data points when you were making your determination to exclude the .9110?

MR. PELLY: Certainly.

MS. NEWMAN: And why is it that you determined to exclude that in light of the fact that there were older data points with similar values?

MR. PELLY: Well, I take issue with the similar values concept but the .91 is the lowest value in the history.

MS. NEWMAN: Well, I'm looking at this column and there's fourteen numbers in it and I've got three of them which are below one. They're not as low as that one particular number but there's three of them below one. Wouldn't it be fair to ... I'd say three out of fourteen is perhaps one number below one every five years. Wouldn't it be fair to reflect that in selecting your average and leave that number below one in?

MR. PELLY: If it was as simple as saying that it was a number below one, but I think instead of .91, if it was .51, would I feel the same ...

MS. NEWMAN: .95, you mean?

MR. PELLY: Yes, the 1995 value. Instead of being .9110, if it was .5110, I think I would feel the same way, it would be an outlier, but if it was .9910, I don't think I would consider it to be an outlier because it falls in the range presented by the earlier history, and that's below one as well, so it's a bit of an oversimplification to just describe it as being below one. That's not a sufficiently refined criteria for making a decision in this regard.

MS. NEWMAN: Again it's an area of judgement though, isn't it?

MR. PELLY: Actuarial work is loaded with judgement.

MS. NEWMAN: Well, I guess in the next column you exercised your judgement twice, two out of five times, 48/36 column. We have two numbers there below one that were excluded, I understand, the .9561 and .9753. Is that true?

MR. PELLY: That's correct. We based our selection on the average of the three latest data points.

MS. NEWMAN: Okay. So in that case you elected to exclude 40 percent of the five data points that you had there.

MR. PELLY: Well, I have a longer history than five data points but of the five latest data points I excluded two of them.

MS. NEWMAN: You elected to exclude that much. Would it be reasonable for another actuary to prefer to leave those two data points in the five year average?

MR. PELLY: Well, in the context of rate-making and given this history, I find it difficult to embrace the .9753 and the .9561 as being reasonable expectations for a future rating period. I mean, the balance of the history is just not supporting values that low.

MS. NEWMAN: But would it be reasonable for another actuary, I understand what your judgement was, but would it be reasonable for another actuary to find that those two out of five data points must somehow represent the possible history for next year?

MR. PELLY: Well, let's look at the values down below. The last five year average is 1.0294 and the last three year average is 1.0719, so I think your question really boils down to whether or not 1.0294 is a value that is reasonably supported by the history. So as I scan up the column, I think there are three data points out of the 13 that are present there that support a value as low as 1.0294. That's not very middle of the road. I would say that is bias (phonetic) low. Reasonable versus unreasonable is a difficult, it's a difficult line to draw in the sand.

MS. NEWMAN: But this data is very recent, isn't it? I mean ...

MR. PELLY: Sorry?

MS. NEWMAN: This data that you're excluding here is very recent. It's ...

MR. PELLY: It's the fourth and fifth most recent data points.

MS. NEWMAN: Right.

MR. PELLY: I'm not disputing that it's recent data and that it happened. It's a question of whether that data point is reflective of normal expectation and it's not reflected, it's not substantiated, it's not, there's not a lot of evidence of it happening on a recurring basis through the history.

MS. NEWMAN: Okay. Well let's look to the column 60/48 because there your exclusion on your own basis that you just said doesn't seem to make sense because there is a lot of data to support it in the older history as well as in the recent history. So we're at 60/48 ...

MR. PELLY: Yes.

MS. NEWMAN: ... and you've excluded, I understand, the data point .9097.

MR. PELLY: I think that's the case. Let me just double check that. Yes.

(10:15 a.m.)

MS. NEWMAN: And if we go back to the older history, we look in 1989, there ...

MR. PELLY: There's one other data point.

MS. NEWMAN: There is a significantly lower data point, 85 94 (phonetic), and then in '88 there's a, not as low, but it's .9576, and even in the last five years there's a number that's .9895, so it's below one while substantially above the number that you excluded. So did you consider the prior history here on this exclusion where we have a number substantially below the one that you excluded and three out of twelve numbers below one?

MR. PELLY: Again, yes, I considered the whole history. The .9097 had one other value in the history that was lower or in the same neighbourhood as that value and that did not, to us, represent a basis for establishing a reasonable expectation for going forward.

MS. NEWMAN: That's two numbers out of twelve.

MR. PELLY: Two numbers out of twelve, yes.

MS. NEWMAN: That's one in six, so it's a good chance in the next little while it might happen again. Is that fair?

MR. PELLY: Well, I guess on that argument it's one in six.

MS. NEWMAN: Let's turn to the accident benefits coverage now, which is Appendix A, page 438. I'm looking at column 36/24 in the top triangle at 438.

MR. STAMP, Q.C.: Which column, I'm sorry, did you say?

MS. NEWMAN: I'm looking at column 36/24, so the second column of numbers. I believe your exclusion here was the .9495, which is the most recent year.

MR. PELLY: I think that's the case.

MS. NEWMAN: Did you consider or was it relevant or important that this was the most recent year that you were excluding here in terms of responsiveness that would seem to be, take some ...

MR. PELLY: That made it harder to exclude it.

MS. NEWMAN: Following along the comments that you've made repeatedly in terms of numbers in the history which substantiate or don't substantiate the exclusion, I look up at that column and I see a whole (unintelligible) of numbers, seven of them that are below one and some of them significantly lower than the number that you excluded, some, most of them right around the number that you excluded. I wonder why in this case the prior history didn't cause you to leave that number in, especially in light of the fact that it was the most recent number.

MR. PELLY: Now, that was a difficult ... this particular coverage was troublesome for sure. We had to move up to using Atlantic data instead of using provincial data and that naturally complicates the process because of the extra variability that is inherently going to exist as a result of doing that for this particular coverage, although it adds critical mass to the data set, it introduces the fact that there are inherent differences as you go from one jurisdiction to another, so you gain a little bit but you lose a little bit too in terms of homogeneity. The exclusion of the .9495 was not taken easily. I acknowledge that in the history there are values that appear as low as that, so it was a troubling coverage to say the least, but one of the other considerations was the pattern of change as we go from one interval to another interval and we made the selection to try and establish a position that we felt was a reasonable position going forward.

MS. NEWMAN: So I take it here then you would accept that it would be reasonable for another actuary to leave that data point in and not exclude it.

MR. PELLY: That's conceivable.

MS. NEWMAN: And similarly in the 48/36 column you excluded the most recent data point, I understand, .9470.

MR. PELLY: This is the 48 to 36 month interval?

MS. NEWMAN: Yes.

MR. PELLY: I believe we took the average of the last five.

MS. NEWMAN: Okay. So there's no exclusion there.

MR. PELLY: That's correct.

MS. NEWMAN: Okay. Well, let's look at the column 24/12, which is the first column, and I note there that there is, there's been no exclusions there either, have there?

MR. PELLY: We took the average of the last five.

MS. NEWMAN: Last five. There is a number there for 1999, the 1.2345.

MR. PELLY: Yes.

MS. NEWMAN: Which is significantly above the other numbers in that column, is that fair to say?

MR. PELLY: Yes.

MS. NEWMAN: There doesn't seem to be, if you look through the prior history there, there doesn't seem to be any number as high as that particular number, is there?

MR. PELLY: No, there isn't.

MS. NEWMAN: So that would certainly seem to be an outlier in my lay person's perspective for the five years that you are using also for the whole time period that we're looking at here. Is that ...

MR. PELLY: Well, one of the ... again, we're working with Atlantic data here and that is, has its advantages and disadvantages. If you flip back to page 4.16, which presents the history for Newfoundland and Labrador, you don't get a value as high as 1.2345 in that history. Oh, yes, you do actually, I'm sorry. You get several values in the high teens and you get one value that's an extreme value in 1995.

MS. NEWMAN: 4.16, we're looking at the top triangle there and you're looking at 1998?

MR. PELLY: Well, I'm looking at the 24 over 12 development factors.

MS. NEWMAN: Right, okay.

MR. PELLY: I'm just ... I'm making the observation that when picking a value of 1.0583 or wondering about the inclusion of a value as big as 1.2345, the actual jurisdictional data, given the early development interval that we have here, does lend broad support for a value as high as that and there is an extreme value from 1995 that's as high, that's considerably higher than that.

MS. NEWMAN: I'm looking at this triangle that you just raised and just pointed us to and I'm looking in the column 36/24, and the most ...

MR. PELLY: Yes.

MS. NEWMAN: The most recent data point there is .8656.

MR. PELLY: Yes.

MS. NEWMAN: It's very low as well. Comparing that to the other exhibit which is the 438, much, much lower than the .9495.

MR. PELLY: Indeed it is. We're dealing with very small dollars amounts here and that's one of the difficulties with this coverage.

MS. NEWMAN: Alright.

MR. PELLY: The very fact that it's a non-compulsory coverage in Newfoundland and Labrador tends to make it a less popular coverage and the corresponding result is that there's considerably less loss, loss dollars involved.

MS. NEWMAN: Mr. Chairman, I propose to move on to the commercial section of this. It's fairly short. I leave it in your hands as to whether you wish to break and come back to that. It's following along a similar sort of analysis, flipping to charts. If you'd rather get it over with and come back fresh, we can press on.

MR. SAUNDERS, PRESIDING CHAIRMAN: Sure.

MS. NEWMAN: It might take me another ten minutes or so.

MR. SAUNDERS, PRESIDING CHAIRMAN: Let's do that.

MS. NEWMAN: Okay. So we're at Appendix B. We'll move away from these accident benefits and on to commercial, Appendix B, page 432. I'm looking at column 48/36. In 48/36 there's a value there for 1995 that's 1.2809. Did you exclude that value? I'm on page 432 of Appendix B.

MR. STAMP, Q.C.: Which column are you in, please?

MS. NEWMAN: 48/36.

MR. STAMP, Q.C.: And what year are you in?

MS. NEWMAN: We're on Appendix B, 432. We're on column 48/36.

MR. STAMP, Q.C.: Sorry, sorry.

MS. NEWMAN: And we're in 1995.

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

MS. NEWMAN: Which is the value of 1.2809.

MR. PELLY: And you're asking if the 1.2809 was excluded?

MS. NEWMAN: Yes.

MR. PELLY: And I believe it was not excluded.

MS. NEWMAN: So if we follow a similar analysis then, I'm looking in the five year history, there doesn't seem to be any number that's even relatively close to that. They all seem to hover at or below one. Would you agree with that?

MR. PELLY: Yes.

MS. NEWMAN: And then looking in the prior history, can you agree with me when I say that there is no number approaching that number, the 1.2809, in the prior history that we have here dating back to 1984?

MR. PELLY: Yes, that's correct.

MS. NEWMAN: Okay. I'm wondering if you can explain why that wasn't considered to be an outlier.

MR. PELLY: Well, we have considerably more volatile experience here so it makes the selection process more difficult. That's part of the reason why we moved up to an Atlantic basis instead of a jurisdictional basis for purposes of factor selection. A large part of it is the expectation for movement as you go from one development interval to the next. There's a lot of judgement involved when you're dealing with small volumes and we have that problem in spades in this particular instance. So it was a judgement call. I agree, the 1.2809 is a high value but I don't think the 1.0570 as the selected factor is unreasonable compared to the selected development factors in the surrounding intervals, and I also don't think it was unreasonable versus the private passenger pattern, if I remember correctly.

MS. NEWMAN: You said that you would look to the data moving year to year but in this case I look at the year before this, couple of years before this value are .93, .76. Years after that are .99, 1.01 and then .93. So in terms of numbers around there, they certainly don't seem to in any way support that sort of ...

MR. PELLY: I was referring to, as you go from one development interval to the next development interval.

MS. NEWMAN: Okay, fair.

MR. PELLY: There is a sort of a, I'll call it an intuitive expectation that there's going to be a pattern of declining values in a reasonably smooth manner as you go from one development interval to the next. I certainly acknowledge that this coverage is harder to do and that's why we move to an Atlantic basis. The consequence of moving to a broader jurisdictional basis is naturally you're going to have more critical mass but the risk of less homogeneity because you've combined jurisdictions.

MS. NEWMAN: Okay. Well, would you agree then it would be reasonable for another actuary to exercise his or her judgement to exclude that particular data point?

MR. PELLY: Certainly judgement plays a much bigger role here, yes.

MS. NEWMAN: 436, please, property damage and commercial vehicles. We're looking in the column 24/12 and I believe you have two exclusions in this column, that would be the years '96 and '97, of .9151 and .9778. Is that accurate?

MR. PELLY: Yes.

MS. NEWMAN: So you've excluded two out of the five again, correct?

MR. PELLY: Yes.

MS. NEWMAN: And there is another number there that didn't get excluded that seems high compared to the other, to the remaining five. I don't think you excluded, you can clarify for me, the next number, which is 1.1458. Was that excluded?

MR. PELLY: No, it wasn't.

(10:30 a.m.)

MS. NEWMAN: Are there other numbers in the five year history or in the older history higher than or similar to that number? I don't see any.

MR. PELLY: There's at least two.

MS. NEWMAN: Where are they?

MR. PELLY: 1987 and 1991.

MS. NEWMAN: Okay. How about for the low numbers, are there any numbers similar to those two low numbers in the prior history?

MR. PELLY: Yes, there are.

MS. NEWMAN: Okay. So perhaps you included the higher number because there was old history to substantiate that, but for the lower numbers there's old history to substantiate those two. I don't understand why the different treatment. Perhaps you could explain.

MR. PELLY: Well, it's partly driven by the consistency of the last three years compared to the inconsistency evidenced by the addition of the two earlier years. It's partly driven by consideration of provincial data as opposed to regional data, but at the end of the day it is a judgement. As I said with respect to bodily injury, when we're dealing with the smaller volumes inherent on commercial vehicles, it is a much more judgemental process.

MS. NEWMAN: And in the ... this is the last comment that I, the last question I have on this chart. In the 48 to 36 column ...

MR. PELLY: Yes.

MS. NEWMAN: ... there were no exclusions, were there?

MR. PELLY: We used the average of the last five years.

MS. NEWMAN: Okay. The last, most recent number is 1.1105. That was included?

MR. PELLY: It was.

MS. NEWMAN: It seems to be a little different than the numbers in the last five years, and in fact I looked back to the prior history and it seems to be the highest number by ten points. Is that fair?

MR. PELLY: It's high and when you look at the corresponding information for the province, that same factor is 1.52. It's a big value and it has influenced our expectation, yes.

MS. NEWMAN: Okay. Those are all my questions on this area. It'd be a good time to break.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. We'll do that, Ms. Newman, and we'll come back at 10 to 11:00. Thank you.

(break)

(10:50 a.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: I guess we're going to have some weather.

MR. STAMP, Q.C.: So it seems. I thought it was just ten centimeters but Ms. Newman tells me it's a lot more.

MR. SAUNDERS, PRESIDING CHAIRMAN: We may have to discuss what we're going to do tomorrow morning in the event that there is any unusual snowfall in terms of timing to get started, but anyway, we'll do that towards the end.

MS. NEWMAN: Yes, I understand the snow may be started by then.

MR. SAUNDERS, PRESIDING CHAIRMAN: Maybe it'll be all over by then. Okay. Everyone is ready. We'll continue, Ms. Newman.

MS. NEWMAN: Okay. Perhaps we'll move on now to loss trends. I believe you said in your testimony, I think it's fair to say that you, one of your primary objectives is to balance responsiveness with stability. Is that what one of your primary objectives would be?

MR. PELLY: I don't know that that's an objective. I think it's a reality of what actuaries do in their work generally, yes.

MS. NEWMAN: Okay. So it's a principle.

MR. PELLY: Okay.

MS. NEWMAN: And you exercise judgement with these principles in mind and with this balancing. Is that fair to say?

MR. PELLY: Fair, yeah.

MS. NEWMAN: Is there any standard or objective measure of this balancing process or is it purely judgement?

MR. PELLY: I think it's purely judgement.

MS. NEWMAN: And with reference to trend in particular, is there any standard or guideline to setting trend or is that judgement as well?

MR. PELLY: There's a lot of guidelines, papers and principle documents, documents on principles of rate-making. None of it is binding. It's all just good guidance.

MS. NEWMAN: Okay. In terms of the issue of the number of years which you used in your analysis, I understand from your testimony to date that you used a significantly longer period of time than did Mercer in their report in establishing trends. You went back up to 18 years. Is that true?

MR. PELLY: For some coverages we used a longer period of time than Mercer's. In others we were very close to each other.

MS. NEWMAN: And one of your objectives, principles, in establishing trend is to, I think you said, look to the long term, establish a long-term trend.

MR. PELLY: What we're trying to do is estimate the underlying annual rate of change in some statistic, be it loss cost frequencies or severities, through time, and although you need to deal with the reality of different pattern changes that do happen, as a rule I favour using a longer history to do that in order to get, to try and capture the underlying forces of change that are occurring in the history.

MS. NEWMAN: But isn't it true at some point you run the risk of the older data being irrelevant or not useful to the analysis?

MR. PELLY: That can certainly happen and there are cases that are shown in our evidence where we truncated the history we use because we did observe a pattern change that was causing us concern.

MS. NEWMAN: So you exercise, you'll use the full period and exercise your judgement to exclude periods of time that do not appear to be consistent with the more recent trend?

MR. PELLY: We typically run, well, a large number of regression models on any particular coverage for private passenger and/or commercial vehicles, and some of the things we often test are to try the sensitivity of using a longer period versus a shorter and more current period in order to see how sensitive the outcome of the regression is. We also base it to some extent on an examination of the actual graph of the historical data, looking for visual evidence of a pattern change which might lead to a suggested break point for excluding an earlier portion of the history.

MS. NEWMAN: Okay. So the longer period of time would appear to be your default position that we've spoke of throughout this and which you may vary from, by exercising your judgement.

MR. PELLY: And I think the filing describes it as such.

MS. NEWMAN: And so you would acknowledge then there are things that arise throughout the course of time that may make that old data irrelevant such as, you know, the introduction of ABS brakes or, you know, improved roads or new driving rules or things like that that might so dramatically change the face of the road that it makes that old data irrelevant.

MR. PELLY: There's certainly a risk of a shift happening at any point in time in the history, either the older history or the newer history. Bear in mind that what we're trying to quantify here is the annual rate of change and not the quantum itself, so if you, if there's a known event that takes place, it's possible to build in a feature for that known event into the regression to capture it, but you don't want to do that unless there is some event that one would link the shift in the curve with.

MS. NEWMAN: With respect to the issue of the semi-annual versus the annual data and the seasonality issue that we've discussed, we've heard that this winter, the 2000/2001 winter, was dramatically different than anything that's ever been experienced here before. Wouldn't that intuitively suggest that the numbers should demonstrate that if there was an outlier that those numbers shouldn't be relevant to the rest of the history or the history going forward, intuitively?

MR. PELLY: It might lead to an expectation that that would be the case, yes.

(11:00 a.m.)

MS. NEWMAN: And then I'd like to look at the specifics of the numbers, the differences between the seasonal numbers that Mercer prepared and the annual data and discuss this concept of outliers. I'll refer everybody to the benchmarks. You can get your copy of the benchmarks filed by Mercer's for 2003.

MR. SAUNDERS, PRESIDING CHAIRMAN: Which benchmarks are we ...

MS. NEWMAN: The 2003 benchmarks.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes, 2003.

MS. NEWMAN: And I'm looking at C-7.

MR. PELLY: Would that be Appendix C, Exhibit 7, page one?

MS. NEWMAN: Page two I'm looking at.

MR. STAMP, Q.C.: Is there a page one of that exhibit, by the way, Ms. ...

MR. SAUNDERS, PRESIDING CHAIRMAN: They're not in order if yours is like mine, Mr. Stamp. I find page ... is it page two?

MR. STAMP, Q.C.: I think page two.

MS. NEWMAN: I'm told ...

MR. SAUNDERS, PRESIDING CHAIRMAN: It's the third from the back.

MS. NEWMAN: ... that they're identical. I don't have a page one myself, I have a page two, but it appears to be the same as page one.

MR. SAUNDERS, PRESIDING CHAIRMAN: It's two or three from the back, page two in mine.

MS. NEWMAN: Yeah. I found that yesterday as well when I was looking for it, I re-arranged it, but it is ...

MR. SAUNDERS, PRESIDING CHAIRMAN: It's a series of three graphs at the bottom, is that the one?

MS. NEWMAN: Yes. I'm looking at the front of that. It's the page just prior to that.

MR. SAUNDERS, PRESIDING CHAIRMAN: The page prior to.

MS. NEWMAN: Yeah.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MR. STAMP, Q.C.: Page two ...

MS. NEWMAN: I think that's the page ...

MR. SAUNDERS, PRESIDING CHAIRMAN: There are two page twos, yeah.

MS. NEWMAN: Page two that I have should be page one.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yeah. Do you want to call that page one?

MS. NEWMAN: We'll change that to page one.

MR. SAUNDERS, PRESIDING CHAIRMAN: So the page with the numbers only will be page one.

MS. NEWMAN: Yeah.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MS. NEWMAN: And the page with the graphs is page two. So we have here in this chart third party liability bodily injury Newfoundland data on a seasonal basis, and I'm looking at the column called "Ultimate Loss Cost," which is two-thirds of the way across in the first table there, first ... "Ultimate Loss Cost." So we're looking at the numbers for the winter, the extreme winter, and that would be third from the bottom, 2000.2 would be the half year, the latter half of 2000. The number is 691. Now, if we look to that same figure for the latter half of 1999, two numbers up, it's 409. So from year to year on a half year basis we have, it appears to me, an increase of 70 or 80 percent in that half year. Is that fair to say?

MR. PELLY: In the year, yes.

MS. NEWMAN: Yes?

MR. PELLY: Well, it's ...

MS. NEWMAN: We're going from 409.51 to 691.17.

MR. PELLY: Close to 70 percent.

MS. NEWMAN: About 70 percent, okay. And then similarly in the first half of 2001 we have a number of 593 87 (phonetic), whereas in the first half of 2000, before the big winter, the number was 421 93 (phonetic), the increase not so large but presumably somewhere around 60 percent.

MR. PELLY: I think it's around 40.

MS. NEWMAN: If you looked, if you were looking at the numbers on a seasonal basis, would you consider those numbers to be outliers in the context of the knowledge that you may have, the common knowledge that exists about the likely reason for those numbers, would you consider those to be outliers?

MR. PELLY: Well, I'd want to run the regression and see whether or not the regression identifies them as being outliers, but I certainly acknowledge that the year over year increase in those half year statistics are large compared to the historical average year over year changes.

MS. NEWMAN: And you would have to look at it to see whether you would wish to exclude it or not.

MR. PELLY: That's right.

MS. NEWMAN: In comparison I refer you to the filing, to the Eckler Report, B 5.2, and that's just the page with one table on it, 5.2. I'm looking at the third column from the right, which is the ultimate loss cost column. Now, the winter, the big winter would span over two years, would it not?

MR. PELLY: It would affect both the 2000 and the 2001 accident years.

MS. NEWMAN: Right. And those two years, from a lay person's perspective, appear to be dramatically different than the years before that, is that fair?

MR. PELLY: Well, they're the two highest values in the column.

MS. NEWMAN: And they appear to be somewhere around 40 percent or so larger than the years preceding.

MR. PELLY: 2000 represents about a 50 percent increase over 1999, if that's helpful.

MS. NEWMAN: And then the, even the year before '99 was smaller again. So did you exclude these two data points when you were doing your analysis?

MR. PELLY: No, I didn't.

MS. NEWMAN: So in your view the 50 percent increase was not enough to bring it outside of the realm of the usual.

MR. PELLY: Well, the 50 percent ... the process for identifying outliers in the regression analysis isn't so much looking at the year over year changes as it is looking at the position of the data point itself against the current regression model and the extent to which that actual data point differs from the fitted line and the extent to which, in the history, actual data points have differed from the fitted line. If the history is showing that you've got a lot of variability around the fitted line, assuming it's still a solid regression, then that will widen the range of acceptability for purposes of identifying outliers.

MS. NEWMAN: And you went ... how far back did you go in this analysis, how many years?

MR. PELLY: We included back to 1984.

MS. NEWMAN: I look in the last number of years, there certainly seems to be a fairly stable number ... if you're looking from approximately '93 to '99, the numbers all vary around 350 or so. Is that fair?

MR. PELLY: Excuse me, let me just correct my prior answer. For purposes of doing the regression fit we only went back to 1989 and then we had two additional data points that we excluded but we did have available a history going back to 1984, and, I'm sorry, I missed your last question while I was thinking of that.

MS. NEWMAN: No, that's fine. It followed up on what you just said. I'll move on now to the unemployment rate usage in the last trend analysis. You said last week, I'm sure it's getting difficult for you to remember what it is you said and when, but anyways you can check this if you wish, but you said last week that intuitively in terms of the unemployment rate you would think that it may be significant in poor times because you would expect more thefts and therefore it might impact the comprehensive ...

MR. PELLY: I think I might have offered that as an example of an intuitive argument for the inclusion of an unemployment variable on a comprehensive coverage.

MS. NEWMAN: Right. But it wasn't found to be statistically significant in the comprehensive coverage, was it?

MR. PELLY: That's correct.

MS. NEWMAN: Can you please tell us where it was found to be statistically significant?

MR. PELLY: Are we limiting ourselves to commercial vehicles now?

MS. NEWMAN: No, no.

MR. PELLY: For private passenger vehicles, the unemployment variable was included for frequency for property damage and for frequency for collision, and for commercial vehicles it was included for frequency for collision.

MS. NEWMAN: So it wasn't found to be statistically significant in property damage commercial?

MR. PELLY: That's correct.

MS. NEWMAN: Why would it be significant in one and not the other?

MR. PELLY: Well, I wish I had the run in front of me to know how close it was to being statistically significant because I don't recall that, so it may have been close but just didn't pass the test, but I'm not sure that I can offer you an explanation for why it would for private passenger and not for commercial other than the possibility that it was close but just didn't quite pass the test.

MS. NEWMAN: Was it significant in bodily injury?

MR. PELLY: No, it was not.

MS. NEWMAN: Why would it be significant in the property damage coverages and not in the bodily injury?

MR. PELLY: Well, the two kinds of coverages are fundamentally different. The property damage element arises in, involves a fairly substantial amount of single vehicle component coverage, so, and often there's no bodily injury component involved there, so they are different kinds of coverages and it's conceivable that they are subject to different influences.

MS. NEWMAN: Okay. In neither the commercial or the private passenger?

MR. PELLY: It wasn't significant for bodily injury in either case.

MS. NEWMAN: And you didn't find it significant in your last filing.

MR. PELLY: As I recall ... I should check. The May 2001 filing dealt with private passenger vehicles primarily and unemployment variable was not included as a statistically significant variable in any coverage there.

MS. NEWMAN: Okay. I think when questioned about this difference by the Consumer Advocate, you might have said, and you can correct me if I'm paraphrasing you wrong, that you attribute the fact that it is now significant where it wasn't last filing because of the new data. Is that fair?

MR. PELLY: I can certainly imagine declaring that to be one possible explanation for it. I'd want to actually hold the two analyses up side by side to try and do that, answer your question more thoroughly.

MS. NEWMAN: So you haven't done any analysis to determine whether in fact it was the new data that caused this change to make it significant now.

MR. PELLY: Well, in a similar vein to the question I just gave you, probably the best way to know the answer is to actually see how close it was to being statistically significant in the previous regression.

MS. NEWMAN: Didn't you also change some other aspects of your analysis with respect to the unemployment variable in this occasion? Didn't you add more years, go back further in time over your last analysis?

MR. PELLY: On some coverages we did, yes.

MS. NEWMAN: And excluded certain years as well.

MR. PELLY: On some coverages, yes.

MS. NEWMAN: And that was different ...

MR. PELLY: The outlier test I think we have in this application is new compared to the May 2001 filing, if I remember correctly.

MS. NEWMAN: So rather than it being the more recent data that is an explanation for the new significance of this unemployment rate, could it be the changes that were implemented and the way it was calculated?

(11:15 a.m.)

MR. PELLY: Well, in the previous analysis we would have examined a long-term fit as well as shorter-term fit, much like we did in the current analysis, and we're going in seeking some correlation between the costs or frequencies in unemployment rate or severities in unemployment rate to test for that possibility. We tested on shorter histories, we tested on longer histories, and if we find that there is a reasonable performing regression for which the unemployment variable is intuitive and statistically significant, then we will gravitate towards that model.

MS. NEWMAN: For clarification purposes, at page 5.1 of your filing ...

MR. PELLY: In Appendix?

MS. NEWMAN: That would be Appendix B.

MR. PELLY: Commercial, yes.

MS. NEWMAN: And also 5.1 in Appendix A, it's similar information for the private passenger. We have two comparisons here. One is based on 2001 AIX and the other is based on 2000 AIX. Was the last filing based on 2000 AIX? I understood that it was based on the 1999 AIX.

MR. PELLY: That's correct.

MS. NEWMAN: So if the Board were to look, to want to find out and compare what was done in this filing versus the last filing, they shouldn't look to this 5.1 by itself. What they should do is look to 5.1 in both Appendix A and B for the 2001 information and then refer to your old filing where the 1999 information is set out.

MR. PELLY: Well, they get the private passenger 1999 AIX information from the (inaudible) filing, not the commercial.

MS. NEWMAN: In terms of the unemployment rate, as a lay person it seems like there's, I think you spoke of this when you were talking about the seasonality that was used by Mercer. You talk about a lot of noise in the analysis and a lot of complexity added to the analysis. It seems like it's very affected by the number of years because we've got this change from last year to this year. So would you agree that it is affected by the data in terms of the number of years you use or the data within one particular year, whatever the reason is for this particular ...

MR. PELLY: It certainly has a bearing on the outcome.

MS. NEWMAN: We have the issue raised by the Consumer Advocate in terms of the provincial data versus the territorial elements that are involved here. You're only using provincial data, so that's another element of uncertainty.

MR. PELLY: I think we agreed to disagree between the Consumer Advocate and myself. I think the analysis of territorial experience will capture the absolute difference between one territory and another territory provided there's fairly good persistency in that difference, so what we're doing is we're building in or utilizing a provincial unemployment rate for purposes of projecting a provincial loss cost and if there are unemployed related influences that are different in one territory versus another territory, provided those are fairly persistent differences, the territorial analysis should capture that.

MS. NEWMAN: But it possibly may not.

MR. PELLY: If there's a lack of persistency in the unemployment information from one territory to another, it may not.

MS. NEWMAN: Also your trends are based in part on future prediction of, predictions of unemployment rate as well, aren't they?

MR. PELLY: And that's probably the biggest weakness of the methodology because clearly the source of that predicted unemployment rate becomes a focal point. When I first started using unemployment rates and I went looking around for forecasted values of unemployment, my first position, my first starting point was going to provincial budgets, government budgets, and often they will contain forecasts of provincial unemployment rates, and when I first started working with that I discovered this interesting pattern that provincial forecasts like government forecasts for provincial unemployment rates seem to be characteristically optimistic, and there's a danger in doing that, including that in my analysis, because what I want is a best estimate basis, as best as I can get as opposed to one that is, has a built in bias, and there's a risk that that will distort the forecast, so we departed from using the provincially-based budgetary forecast for unemployment and tried to go to hopefully an authoritative and independent third party for the forecasted and we're currently using the Conference Board of Canada forecasts.

MS. NEWMAN: So in light of those items that I've just highlighted and you've agreed to them in part, would you think it would be reasonable for another actuary to find that the unemployment rate is not a statistically significant factor given the uncertainties that may be associated with it?

MR. PELLY: I think it would be hard to conclude that it's not statistically significant, but I can understand that when you look at the sensitivity of the projected frequencies to the projected unemployment rate or movement in the projected unemployment rate, I'm not sure that another actuary couldn't pick a regression model that did not include the unemployment variable and still conclude that they have a reasonable model. I wouldn't require another actuary, if I was reviewing another actuary's work, I wouldn't impose utilization of an unemployment rate unless I found that the two answers were so diametrically opposed to each other that I couldn't rationalize the difference between the two.

MS. NEWMAN: I'd like you to refer to BGP-3. That's the series of graph charts that you provided, number 21.

MR. PELLY: I have that.

MS. NEWMAN: This is the private passenger comprehensive frequencies trend responsiveness. I note here on this chart you're showing a regression analysis on the Mercer trend of negative 1.57.

MR. PELLY: Yes.

MS. NEWMAN: I'm at page 21. So you're showing a regression analysis on the Mercer trend, they've used a negative 1.57, and you've got an as filed number there of negative 6.8, and you've got a regression analysis done on that, however, you didn't adopt that or FA didn't adopt that negative 6.80, did they?

MR. PELLY: Oh, no. The future frequency trend ... this is on the subject of future frequency trend?

MS. NEWMAN: Right.

MR. PELLY: Yes, that's right, we used an overriding assumption of a flat future frequency trend.

MS. NEWMAN: Okay. So did you do a regression analysis on your changed assumption of zero? No, you can't do a regression analysis on that number. You've got a number of negative 6.8 that you've done a regression analysis on.

MR. PELLY: Yes.

MS. NEWMAN: It's a fairly respectable regression analysis but ...

MR. PELLY: Fairly.

MS. NEWMAN: ... you exercised your judgement to assume zero rate instead.

MR. PELLY: Yes.

MS. NEWMAN: And you can't do a regression analysis on that because it's judgement.

MR. PELLY: Well, maybe a better graph ... I think I included one here. Let me just try and find it. It would be page 24 on this subject, which is the graphical representation of the same situation. At some point we will reach a point where we consider 1996 to be another one of these change points where the pattern of the past has stopped and a new pattern has begun. I'm not sure I'm there yet but the early evidence is that 1996 is my likely change point. It would be possible to do a regression on the years from 1996 through to 2001, and I'm not sure what answer that would provide but it's going to be something pretty close to flat.

MS. NEWMAN: I guess when I look at this, it seems to highlight for me the limitations of the regression analysis, because you did a perfectly wonderful regression analysis showing a trend of negative 6.8 and yet you acknowledge that it's not particularly useful at the end of the day because the more recent numbers probably carry the day. Would you agree that that kind of highlights the difficulties associated with a regression analysis or the limitations of a regression analysis?

MR. PELLY: Absolutely, and that's what I was getting at earlier when I talked about the importance of picking the historical period.

MS. NEWMAN: And if you had chosen a shorter period as did Mercer, you would have gotten a flatter trend, wouldn't you?

MR. PELLY: That would be my expectation.

MS. NEWMAN: So might it have been appropriate in this instance to take a shorter period rather than discounting your analysis altogether and just adopting a zero?

MR. PELLY: Well, we did examine looking at some shorter periods. We weren't satisfied with the performance of the regressions yet. I don't know whether it's time yet to use as short a history as from 1996 onwards. I expect I will reach that point soon but I didn't feel that the zero percent frequency trend was inappropriate given the pattern of change of the, just on a judgemental basis, given the pattern of change of the last several data points, but it certainly ... frequencies are the statistics on which this issue arises most frequently where we get pattern changes, and the pattern change that we have evident here in Newfoundland and Labrador is actually very very similar in timing to pattern changes that are evident in other atlantic provinces and in fact in other, in Ontario and Alberta jurisdictions as well. There seems to have been a shift in the late '80s, early '90s, in claim frequencies to change it from being a generally flat or upward slope to a generally downward slope, and that pattern is basically, reached a bottoming out phase in the mid-90s and has been proceeding on a generally flat basis going forward since then, but I would maintain that for trending purposes, for purposes of building an expectation, what the long, what the forces of change are, you need more of a history than just four or five data points, and that's what I'm waiting for.

MS. NEWMAN: It would strike me as preferable to do that analysis than simply just picking a number based upon the visual, which is what you seem to have done. I mean, wouldn't a less perfect regression analysis be better than just looking at it and picking a number?

MR. PELLY: I guess it depends how less than perfect it is.

MS. NEWMAN: I move on to the next, the third of my four major headings, and that is some miscellaneous items that I wanted to get out of the way, and then I'll move on finally to some implementation issues I need to discuss. So the first thing I want to point you to is BGP-4, which is the chart, single page chart that was prepared and presented in direct testimony.

MR. PELLY: I have that.

MS. NEWMAN: Okay. In reference to this chart I believe you said in your testimony, again you can correct me if I'm misquoting you, but that there was, this chart demonstrated a cause and effect relationship. Is that fair?

MR. PELLY: I may have used those words. I certainly can imagine saying that I see a correlation here between the relationship between FA, Facility Association, and industry average premiums and market share.

MS. NEWMAN: Okay, but you wouldn't necessarily go so far now in hindsight as to say there is a cause and effect relationship?

MR. PELLY: That's a fairly strong statement. If I made it, I made it, but I don't know that I can prove it.

MS. NEWMAN: Okay, alright. Because it is true that there are many factors that may affect this relationship here, people around here tell me, underwriting guidelines, alternative risk sharing mechanisms, competitiveness of the regular market, legislative or other activities that might be put in place to control the relationship here. There is a number of other factors that may go to creating this potential cause and effect, is there not?

(11:30 a.m.)

MR. PELLY: The market is a dynamic thing, yes.

MS. NEWMAN: Okay. In terms of the unallocated loss adjustment expense provision, I think you said a couple of times in your testimony to date, and we can go to the references if you wish, but it's probably not necessary, that Mercer criticized you, criticized FA for not including the updated information, that the updated information should have been included in the initial filing. Is that ...

MR. PELLY: That's my understanding, yes.

MS. NEWMAN: Do you ... I'd like for you to point out in the Mercer Report where they actually do criticize you or say it should have been included in the initial filing.

MR. PELLY: It arises twice, once with respect to private passenger vehicles and once with respect to commercial vehicles.

MS. NEWMAN: I think the bigger explanation is with respect to the private passenger, right?

MR. PELLY: And that appears on page 18 of the Mercer Report, and under the heading "Unallocated Loss Adjustment Expense Provision." In the first paragraph, the last sentence, "We find the updated factor to be more appropriate and recommend its use."

MS. NEWMAN: But they're not saying that it should have been used in the first instance or criticizing FA for not using it. Don't they acknowledge that it wasn't available at the time that you ...

MR. PELLY: Well, that's what makes it all the more curious. I mean, they're recommending that it should have been used and ...

MS. NEWMAN: No. They don't say that it should have been used. They say, "and recommend its use."

MR. PELLY: Well ...

MS. NEWMAN: It's a small point but I don't want you to feel as though they've criticized you.

MR. PELLY: Well, it's nice that you're looking after my feelings.

MS. NEWMAN: Yes, we do our best. And in terms of determining the rate level need for third party liability, FA combined the experience of the bodily injury and the property damage, and you on direct, I believe, commented that it was a worthy suggestion to separate out these two coverages and you were going to take it back for consideration perhaps in future filings. Is that correct?

MR. PELLY: That's correct. This is in the very final stages of the analysis, the provincial indications. We do do a lot of analysis on a split basis but ...

MS. NEWMAN: Okay. And were you aware that in Mercer's evaluation of the last filing they had made this same recommendation?

MR. PELLY: I recall that, yes.

MS. NEWMAN: Did you consider that at the time to be a worthy suggestion as well?

MR. PELLY: Well, you may recall that the circumstances surrounding ... well, maybe you wouldn't recall, but the circumstances surrounding the approval or the review of the previous filing didn't lend itself to the same rigour as this occasion and not as much time was spent assessing the various comments raised in the Mercer Report on that occasion, because of that difference.

MS. NEWMAN: Again in BGP-3 in your series of graphs and charts, page ten, I think, I believe you said in testimony when discussing this graph, and I'm looking at the data point 1999, you said this, so in the 1999 AIX, and this is industry data, the estimate that was made for the ultimate cost of claims has proven to be inadequate by about $40. I just want to clarify that, what these numbers represent, and in fact whether this does prove this or not. This blue line that's here, what does that represent?

MR. PELLY: That's the estimated ultimate loss costs from the 1999, the analysis of the 1999 AIX industry experience for this coverage.

MS. NEWMAN: Okay, and that was estimated by who?

MR. PELLY: Well, it would have arisen from our previous application, so it would have, we would have taken ownership of the estimates to a substantial extent, we would have relied on some industry development assumptions, but they would have been our estimates.

MS. NEWMAN: Okay. And how much of that data is actually paid?

MR. PELLY: Oh, I mean, that's the whole issue about loss development. I'd have to look at the actual experience but it's a relatively small percentage at that early age.

MS. NEWMAN: And the red line, what does that represent?

MR. PELLY: Comparable information but based on 2001 AIX industry data for that coverage.

MS. NEWMAN: Okay. Estimated by who?

MR. PELLY: Again, me.

MS. NEWMAN: Okay. And what percentage of that would have been paid at the time that it was estimated in reference to 1999?

MR. PELLY: For the corresponding 1999 accident year more as a percentage of the whole would have been paid, so you have a somewhat more, call it a historically factual basis in a sense that dollars paid are dollars paid, they're not going to change. The estimate of the unpaid portion of the ultimate cost of claims is the unknown piece that's being estimated in each instance and the current estimate is that it's more adverse than was the case in the 1999 AIX.

MS. NEWMAN: So in order of magnitude, would about 50 percent of that number in red be paid now or are we talking ...

MR. PELLY: Let me see if I can find that. I don't think that appears anywhere in the application that I can think of.

MS. NEWMAN: If you refer to 6.1, I'm told that you might find an answer to that.

MR. PELLY: I think that's only going to give us Facility Association data. This chart on page ten is industry data. It is available but I ...

MS. NEWMAN: Would the numbers be similar?

MR. PELLY: Going on expectation would be that there'd be some similarity but development patterns are different between Facility Association and industry, so I'm hesitant to promise you that they're similar.

MS. NEWMAN: Alright, but the number here would be what? It looks like seven percent, is that accurate, that would be paid, from 6.1, if we're talking about the different data?

MR. PELLY: Just for clarification to the Board, page 6.1 is the basis for establishing pay-out pattern expectations, so the triangle of numbers shown at the top of the page is the ratio of dollars paid to the estimate of the ultimate cost of claims, and, as Ms. Newman points out, our selected percentage as of 12 months was at 7.62 percent of the ultimate cost of claims would be paid at the end of 12 months, so the 1999 accident year would now be 36 months of age and that, looking at the 36 month column on this same page, that's about a 48 percent assumption for the percentage that would be paid. Now, my caution here is that these are, this is an analysis of Facility Association pay-out patterns and Ms. Newman's question was with respect to industry data and I don't have that ...

MS. NEWMAN: Fair enough.

MR. PELLY: ... industry analysis here.

MS. NEWMAN: Fair enough. Again it's a minor point, just going to the fact that this chart really doesn't prove anything yet until the final numbers are ready.

MR. PELLY: No. What it reflects is today's expectation versus yesterday's expectation.

MS. NEWMAN: In reference to the accident and conviction surcharge, I wonder if you could refer to the narrative portion of your report, which is page 22, the accident and conviction surcharge schedule, page 22 of the narrative, Section 5. There's reference here to, in reference to this, the surcharges, minor convictions, major convictions and serious convictions.

MR. PELLY: Yes.

MS. NEWMAN: I wonder if you could point me where they're defined, what constitutes a minor versus a major versus serious. Is that in the filing?

MR. PELLY: It's not in the filing document. They're defined in the Facility Association manual.

MS. NEWMAN: Okay. So that would be in a servicing carrier's manual that we have filed?

MR. PELLY: I think it's just called The Manual of Rates and Rules or Rules and Rates.

MS. NEWMAN: That would be in PUB-14. Is that the document that we're talking about here? PUB-13?

MR. O'FLAHERTY: Mr. Chairman, I can specifically recall leaving that document behind, so I'm wondering if the Clerk, if there is another copy around, if we might have an opportunity to read along while this testimony is going ahead? I apologize for that.

MR. SAUNDERS, PRESIDING CHAIRMAN: See if Ms. Blundon can help you out there now.

MS. NEWMAN: PUB-13?

MR. SAUNDERS, PRESIDING CHAIRMAN: 13?

MR. STAMP, Q.C.: The document ...

MR. O'FLAHERTY: I have one, thank you.

COMMISSIONER MARTIN, Q.C.: I've got a manual of roots *(sic)* and, or ...

MS. NEWMAN: A thick document.

COMMISSIONER MARTIN, Q.C.: ... rules and rates as ...

MS. NEWMAN: Yeah, Facility Association Servicing Carrier Manual of Rules and Rates.

COMMISSIONER MARTIN, Q.C.: Mine is under PUB-3. It's the same document.

MS. NEWMAN: Okay. A typo, it's 13 ...

MR. PELLY: I have that now.

MS. NEWMAN: Okay. That is the correct document, is it?

MR. PELLY: Facility Association Servicing Carrier Manual of Rules and Rates.

MS. NEWMAN: Right, okay.

MR. PELLY: And the, I'm not sure how it's identified in your, in everybody else's binders, but I have a series of numbered tabs in this binder.

MS. NEWMAN: Right, yes.

MR. PELLY: And Tab 2, if you open that and look at the first page behind Tab 2, if it says "Section B, General Rules," then you're in the same place as me, and if you go through the, within that section to Rule 30, which starts on page B, as in "Brian 2," towards the top on the right-hand side, it begins, this particular rule spans a couple of pages, but it begins with a subheading of (a) for "accidents" and has a number of items of information with respect to accident surcharges, and then about the middle of the left-hand column on page B 3, with a subheading of (b), "Convictions," it begins a discussion of conviction surcharges and the details of the three categories of convictions are defined starting about a quarter of the way down on the right-hand column of page B 3.

MS. NEWMAN: Okay. So paragraph (a) there under Schedule of Additional Charges for Convictions, on the right-hand side of B 3 ...

MR. PELLY: Yes.

MS. NEWMAN: ... what does that represent, because I don't think the terminology, minor, major and serious, are incorporated into these definitions?

MR. PELLY: I think you may be right too. The first category relates to major convictions, the second category under heading (b) relates to, what we've referred to as minor convictions, and the third category, lower case (c), is what we've referred to as serious convictions. I think this terminology, minor, major and serious, is probably commonly used within the Rates and Rules Committee and may be industry jargon.

(11:45 a.m.)

MS. NEWMAN: Okay, alright. I understand that FA is seeking to introduce a discount in this filing of ten percent for a clean driving record. Is that fair?

MR. PELLY: For what's referred to as a clean driver discount?

MS. NEWMAN: Yes.

MR. PELLY: And it's driving record in the sense that it's accident and conviction record.

MS. NEWMAN: Okay. Is there some overlay between the driving record and this discount in the sense of when establishing rates for insureds, Facility will look to the driving record to set a rate. So can you please explain the overlay between the driving record analysis and this discount that's proposed?

MR. PELLY: The driving record rating criteria loosely defined is number of years claims free but it requires an eligibility to realize that by having the corresponding number of years of driving experience. There are also a number of additional characteristics that are necessary to qualify for a particular driving record. The definitions of those rating characteristics appear in the private passenger section of the manual. So it's possible for ... an example would be a youthful operator who takes an accredited driver training course, I believe, is eligible for driving record three when they first start writing, driving and requiring insurance, so they may not have actually earned a three year driving, claim free driving record but they are deemed to have earned it by virtue of the application of the rule, and there are a lot of other rules that relate to the categorization of driving record, but in its simplest boiled down form you think of driving record as years claims free and that's understandable. The accident element of the accident and conviction surcharge schedule captures, in a negative way captures the at fault accident attribute as well in sort of taking people from being categorized as driving record zero to surcharging them for the frequency of their claims. The clean driver discount is sort of the other direction from what the accident and conviction surcharge schedule is trying to accomplish and it's an acknowledgement that there are risks in Facility Association who are there for reasons other than their accident and conviction record and it's seeking to provide a lower rate to those policyholders who are in there for those other reasons, whatever they might be.

MS. NEWMAN: I'd like to just go through how this might work and I think a good starting point would be Table A, 2, 22, (phonetic) Appendix A, Tab 2, page 22.

MR. SAUNDERS, PRESIDING CHAIRMAN: Are you in the Eckler Report?

MS. NEWMAN: Yes.

MR. PELLY: I have that.

MS. NEWMAN: Can you please explain what this ... okay. We're in the Eckler Report ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MS. NEWMAN: Part A, Tab 2, page 2, 22 (phonetic).

COMMISSIONER POWELL: When you say Part A, Appendix A?

MS. NEWMAN: Appendix A, yeah.

MR. SAUNDERS, PRESIDING CHAIRMAN: Page 2, 22?

MS. NEWMAN: I'm missing our monitors now. Okay. Can you please explain what this table represents?

MR. PELLY: This is a two dimensional table of the distribution, the estimated distribution by conviction record and by accident record that was assembled based on a special data extract prepared by one of the Facility Association Newfoundland and Labrador servicing carriers. The numbers that appear in the body of the table represent exposures or vehicle counts, roughly speaking. Across the top are the number of at fault accidents within a prescribed, I think it's a five year period if I remember correctly, sorry, three year period, and the rather convoluted labels appearing down the left-hand side where there's three numbers separated by hyphens, are the number of minor and then major and then serious convictions in the previous three years. Now, roughly speaking, the assumption made was that all of the people in the category in the uppermost left, top left corner of the chart, would be eligible for the clean driver discount.

MS. NEWMAN: So for this one carrier, of the 3,000, 3,129, in the bottom right-hand corner, that would represent their total vehicle counts?

MR. PELLY: During that particular period.

MS. NEWMAN: During the three year period. The top left-hand number of 1,675 suggests that over half of their total vehicle counts are conviction and accident free for the last three years.

MR. PELLY: That's correct.

MS. NEWMAN: And when you were looking at this discount to, you know, do your off balance factors, these are the numbers that you look to?

MR. PELLY: It was.

MS. NEWMAN: You didn't have the information from the other servicing carriers?

MR. PELLY: We put a special call out to all of the, actually all of the servicing carriers and only one was able to provide information that was even close to a format that lent itself to this calculation. It was a special call and different carriers have the information organized in different manners, and this was the only carrier that was able to comply. It's an imperfect extraction in several respects but what we found was that it was, we got good consistency across jurisdictions and we got logical consistency between private passenger and non-private passenger extractions, and Mr. Simpson had also ordered a special run done by the Insurance Bureau of Canada and we got fairly good consistency with that run as well, so although we can't prove the data, we had enough other reference points with this result that we were fairly comfortable with the utilization of this experience.

MS. NEWMAN: Okay. I want to use this to take us on an example of how this discount might be implemented, but first just for the record I'm looking at what appears to be an error in the calculation along a row ... we're at, about mid way down the table, 030000.

MR. PELLY: Yes.

MS. NEWMAN: It starts 34.21.

MR. PELLY: Yes.

MS. NEWMAN: The total across the page is 2.77. I'm assuming that that is an error that was reversed with the second row down from that.

MR. PELLY: I agree, that looks like it's a presentation error.

MS. NEWMAN: A little mix up in the order of the numbers. Oh, there are other errors as well.

MR. PELLY: Yeah, it may be that the last column ... I know we, I asked for a re-ordering of the information and it could be that the last column wasn't re-ordered at the same time. I'm happy to confirm that it doesn't have any impact on the overall answer but I believe that it, all we use is the actual information in the interior of the table and the grand total.

MS. NEWMAN: So in implementing this discount, the 16, if these numbers are correct, approximately 1,600 or 1,675 will be entitled to the discount of ten percent, is that correct?

MR. PELLY: That's the working assumption that was used, yes.

MS. NEWMAN: Okay. And this is, to have a zero, it's a revenue neutral implementation, I understand?

MR. PELLY: The rate level impact overall of the introduction of the integrated package of the clean driver discount and the changes to the accident conviction surcharge, that rate level impact has been recognized in putting forward the base rates, so to the extent that we've asked, requested for an overall increase of a certain percent in rate level, if a portion of that can arise from this change, the integrated change or the clean discount and the accident conviction surcharge schedule, then the remainder needs to arise from some place else and in that sense the recognition is done on a revenue neutral basis.

MS. NEWMAN: Okay. So is it true that the surcharges that are being proposed will not offset, the revenue from the surcharges that are being proposed will not offset in total the discounts that will be applied here so that there will have to be some change to the base rate to implement these changes?

MR. PELLY: That's correct. The average ... maybe the little table in the top, I don't know, towards the top right-hand side of the page, there's a small box with three phrases and three numbers in it. The first row says, "Current average differential of 1.186," and the second row says, "Proposed average differential of 1.202." Those numbers represent the weighted average using this distribution shown in the box below of the current set of the integrated package of the clean driver discount and the accident and conviction surcharges and then the proposed set, so what you can see is that on average the average, sorry, the average overall differential has gone up as a result of the integrated package of changes.

MS. NEWMAN: So effectively then, when you make it all come out in the wash, a clean driver discount will not be ten percent because the base rate is going up.

MR. PELLY: No. If ... let's assume there was no rate level change being proposed in this application ...

MS. NEWMAN: Right.

MR. PELLY: ... just for a moment.

MS. NEWMAN: Yeah.

MR. PELLY: Then the base rate would come down a little bit to offset the fact that more revenue overall will arise from this integrated package of changes.

MS. NEWMAN: Okay, alright.

MR. PELLY: So the base rate will come down a little bit and then the clean driver discount, if you want to think of it as being applied to the base rate, which really it isn't, but if you think of it that way then that would be a further reduction.

MS. NEWMAN: Okay. Can I refer you to B 212? This is, I believe, similar information in the commercial context.

MR. PELLY: I have that.

MS. NEWMAN: It's a point of clarification really. What does this represent?

MR. PELLY: It's the same general calculation that we're applying here for purposes of doing an off balance adjustment for commercial vehicles. Probably the important difference is that the distributional data that we have in the table relates to what the servicing carrier referred to as non-private passenger vehicles, in other words, vehicles other than private passenger. It was the only surrogate that they were able to provide us with and we used it.

MS. NEWMAN: Okay. So it's more than commercial ...

MR. PELLY: It is.

MS. NEWMAN: ... included in here. Okay, alright. That was my question, because I knew the numbers were larger there than we had. Mr. Chairman, this is ... I'm finished with that line of questioning. I now plan on moving to the implementation issue. I don't know if you prefer a break now or I can push on.

MR. SAUNDERS, PRESIDING CHAIRMAN: No. I think we'll break now and come back at 12:15. Thank you.

(break)

(12:20 p.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: Mr. Pelly, are you ready to resume?

MR. PELLY: I am.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, Ms. Newman?

MS. NEWMAN: Mr. Pelly, I'm told by my Board Secretary that it would be great if we could have an updated revised page A-22, is that possible for you to do that, just for our record, without too much trouble?

MR. PELLY: I will make arrangements to have that happen.

MS. NEWMAN: Okay.

MR. PELLY: And just to clarify, that's Appendix A, page 2.22.

MS. NEWMAN: Right. Though we have your testimony that it doesn't affect your calculations.

MR. PELLY: That's my understanding.

MS. NEWMAN: Maybe, could you confirm that too then?

MR. PELLY: Well, it will come out of the calculation, but I know at the last minute I asked them to do some reordering.

MS. NEWMAN: Okay.

MR. PELLY: And if you're familiar with Excel, it's conceivable that the last column may not have been reordered at the same time.

MS. NEWMAN: Okay.

MR. PELLY: But I don't think the answer changed, to my recollection, so I'm pretty sure the calculation didn't get affected.

MS. NEWMAN: Okay, I'm going to move on to my next and last topic, which is implementation, and it's very broad, although it shouldn't take it too long, I'm thinking maybe 20 minutes or so. The first thing I'd like to address is that the proposed rate indication varies, I know, but it's around 40 percent or so, but clearly that's an average, so there are some items that are, some rate increases that are higher than that, and some that are lower than that, is that true?

MR. PELLY: That's correct.

MS. NEWMAN: Do you have an idea, can you tell the Board what the largest single rate increase would be that would be for a particular category driving record and class?

MR. PELLY: I don't think I could provide that with any degree of precision, and there would always be the risk that whatever I did calculate there wouldn't actually be a policyholder in that particular cell, so I would suggest that I cannot provide that readily.

MS. NEWMAN: Okay, and similarly for the smallest rate change, you wouldn't be able to calculate that either.

MR. PELLY: The same problem.

MS. NEWMAN: Okay, well ...

MR. PELLY: The best way to be able to do that is using some form of in-force file that for Facility Association, it doesn't exist.

MS. NEWMAN: Okay.

MR. PELLY: And that's because it works through servicing carriers and therefore it is dependent upon each of the servicing carriers, and it doesn't have a single source for data like that.

MS. NEWMAN: Okay, alright, I wonder if you could quickly calculate what the rate change would be if I gave you the, for one particular class and driving record if I gave you the territory, would you be able to do that quickly?

MR. PELLY: For a given coverage.

MS. NEWMAN: Yeah, so if we took liability only, $200,000, class 19, driving record zero, which from our quick calculations would appear to be a fairly large rate change, would you be able to calculate that now, or is it something you'd want to do later and bring it back to us?

MR. PELLY: I think we can probably do it now because we have the Appendix C, Tab 9 information with the proposed premiums.

MS. NEWMAN: Okay.

MR. PELLY: And with a little luck. Well, if my copy of the current rate manual was complete, we would have it, but unfortunately it's not, but we would have the corresponding current rate pages. Can we do territory three, that's the territory that I happen to have in this manual.

MS. NEWMAN: Sure.

MR. PELLY: Or provide me with a complete copy.

MS. NEWMAN: I think we'll probably be able to find one for you now. Yeah, we have a ...

MR. PELLY: Thank you. This is, sorry, this is the proposed rates.

MS. NEWMAN: Oh, the servicing ...

MR. PELLY: And I was referring to the current rates, so this was in the manual of, the servicing carrier manual of rules and rates, and my copy of that binder is slightly incomplete. That's under Tab ... at the very back of Tab 3 of the manual.

MS. NEWMAN: It goes from page one to page six, is that the problem?

MR. PELLY: That's the problem. If we can do territory three, I think we can do that.

MS. NEWMAN: Yeah, we can do that and perhaps you could undertake to provide us with ... because this is the Board copy, I believe, provide us with the missing pages.

MR. O'FLAHERTY: Just so I can orient myself, Mr. Chairman, I'm wondering if I might ask, are we looking at the current rates for May the 1st of 2002, is that what we're looking for, for private passenger?

MR. SAUNDERS, PRESIDING CHAIRMAN: That's what I've got here.

MS. NEWMAN: Is that what you're looking ...

MR. PELLY: I think so, yes.

MR. O'FLAHERTY: So are those the green pages in the answers to PUB-13?

MR. PELLY: That would be the normal colour, yes.

MR. O'FLAHERTY: So I think they are available. Mr. Byrne just lent me his copy of it.

MS. NEWMAN: Yeah, this is what was filed with the Board, and Mr. Byrne must have had a copy outside of the filings.

MR. STAMP, Q.C.: The copies filed with the Board included territory one.

MR. PELLY: It's probably a problem that just arose in the photocopying, I would guess, either here or ...

MS. NEWMAN: Yeah, it must have been.

MR. PELLY: ... somewhere in the transition.

MS. NEWMAN: But you have the ...

MR. PELLY: Mr. O'Flaherty has kindly lent me the version of the current rates, the May 2002 rates that were provided to him by Mr. Byrne, so you were asking about class 19?

MS. NEWMAN: Class 19, driving record zero.

MR. PELLY: Third party liability.

MS. NEWMAN: $200,000.

MR. PELLY: Territory one?

MS. NEWMAN: Yes.

MR. PELLY: The current premium is $1,852, and the proposed premium is $3,374, and that's before any possible application of a clean driver ... well, I guess there wouldn't be a clean driver discount in this instance.

MS. NEWMAN: But there may be application of a surcharge, is that ...

MR. PELLY: As there may be under the current rate too.

MS. NEWMAN: Right, the surcharges are proposed to be changed as well.

MR. PELLY: But there may be a steeper surcharge because the sum of the surcharges are changing.

MS. NEWMAN: Right.

MR. PELLY: So in percentage terms, that's an increase of 82.2 percent.

MS. NEWMAN: Okay, plus a potential increase for the surcharge. Now, this is only liability, is that correct, so CLEAR doesn't apply, changes that are caused by CLEAR is not relevant, are not relevant here, is that ...

MR. PELLY: That's correct.

MS. NEWMAN: But if this person were to purchase more full coverage then those changes might also impact him, is that ...

MR. PELLY: If they chose to purchase a higher limit of liability, yes.

MS. NEWMAN: Alright, and according to the numbers I have here, and I guess it makes intuitive sense, if we were to do another, what we would expect to be a lower change, that would be a class one, driving record five, and similarly, territory one, liability limit only of $200,000.

MR. PELLY: I'm not sure that you'd necessarily expect it to be a lower change going in.

MS. NEWMAN: No?

MR. PELLY: That depends upon the relative adjustments to the underlying class of driving record differentials in which they, where they moved in response to the experience.

MS. NEWMAN: Uh hum.

MR. PELLY: But we'll see.

MS. NEWMAN: We'll see.

MR. PELLY: Class 01, driving record five, $200,000 limit, territory one, the current premium is $1,061, 1-0-6-1, and the corresponding proposed premium is 1-5-4-6, $1,546, for an increase of 45.7 percent.

MS. NEWMAN: Okay, so that's consistent with your rate indications which are set out on page one of the narrative report. It says for territory one, liability on average will experience a 60 percent increase.

MR. PELLY: 60.5 I think is the number that appears there, yes.

MS. NEWMAN: Yeah, so this is the range around that.

MR. PELLY: Well, it's ...

MS. NEWMAN: That I can ...

MR. PELLY: Well, it's two numbers that at least fall within a range around that, yes.

MS. NEWMAN: Yeah, yeah, okay. Can you, in terms of implementing the proposals here, or any changed proposals that may be ordered by the Board, can you speak to how long will be required for implementation by FA?

MR. PELLY: I have some knowledge of that, just from the process that we go through in choosing trend duration assumptions for purposes of developing the indications, the current timeline from the time of approval or notification of approval from the regulator is approximately 105 days, not working days, but 105 days, roughly three and a half months to implementation.

(12:30 p.m.)

MS. NEWMAN: Alright, so clearly the February 1 date is not going to be possible, I think you've testified to that already. Will changes need to be made to your proposal to account for this delay in implementation?

MR. PELLY: I would say no, but the ultimate authority for that doesn't rest with me.

MS. NEWMAN: Okay.

MR. PELLY: I think in the normal course, if the delay is just unfortunate and the process has moved as quickly as the process can move, then we live with, we tend to live with the timelines, but on the previous occasion when the Board, when the Board's expert provided an assessment of their view of the required increase, the timelines at that time were longer than we're talking about right now, and we just brought back to the Board's attention, the fact that we were facing a fairly significant implementation delay compared with what was being assumed in the original application, so all we would ask is that the Board give similar consideration when they're rendering their decision this time, that the indications and the proposals based on those indications reflect an assumption of a certain effective date, and to the extent that that's not realizable, that that can be considered by the Board in rendering their decision, then that would be welcomed.

MS. NEWMAN: Okay, if the Board makes orders that there be changes made to the proposals here, will there be time in addition to this 105 days necessary for the new calculations to be made?

MR. PELLY: Probably not. It would depend upon what the order would state, but under normal circumstances we can work with Facility Association staff to incorporate the modifications incorporated in a Board order. I guess it's always possible that there will be something different than what I've experienced in the past, but normally we can manage it.

MS. NEWMAN: I'm thinking about the updated information, the ULAE information, that factor, would that cause a significant time lag, or could you implement that fairly quickly?

MR. PELLY: That would only affect the indications, of course, whether or not that affected the proposal would ... I'm not sure what the internal timeline necessary for that would be.

MS. NEWMAN: Okay, whether the, whether Mr. Simpson and Ms. Hepburn might feel that the impact was modest enough that they could, they have the authority to put forward, or whether they had to go to the board of directors, I don't honestly know. If it involved going to the board of directors, then that's, that's going to require extra time.

MS. NEWMAN: Okay, so we should speak to somebody from FA perhaps on that issue?

MR. PELLY: It's going to end up depending upon what the issue is that's being addressed, but I would just simply say that if there is a difference of opinion between the Board's expert and myself with respect to the indication, then this Board is in the position of being able to render a decision on the proposal that reflects consideration of that difference of opinion on the indication, so for example, if the Board's expert's view is that I have overstated the indications by one percentage point because of unallocated loss adjustment expense, then it's within the power of this Board to make a decision that reflects that difference of opinion, whichever way they want to side.

MS. NEWMAN: So you don't take any issue with the rate indications or the impacts of the differences highlighted by Mercer then?

MR. PELLY: I have not gone through the process of reassessing it but I'm taking their work as being professional and accurate on the face.

MS. NEWMAN: You mentioned in terms of CLEAR that it's possible that the Board may decide that CLEAR, the implementation of CLEAR could be delayed but that there would be some significant cost associated with that. I wonder if you could explain that?

MR. PELLY: It wasn't the delay issue, it was the phasing in. It was the Board actuary's recommendation that, sorry, yeah, the Board actuary's recommendation that this Board give consideration to requiring Facility Association to place limitations on the dislocation arising from the implementation of CLEAR, in effect phasing in the implementation of CLEAR. My evidence was that I think there are alternatives to that that might be worth exploring, and rather than subjecting the servicing carriers to the expense of the system changes necessary to implement a phasing in process, if this Board has concerns about policyholder dislocation based on the evidence in this application, and if they felt that a more up-to-date dislocation study would alleviate them, or could alleviate them of those concerns, that would be, I think, a more attractive course of action from Facility Association's perspective than mandating a phasing in approach going in, simply because at the very least the servicing carriers did it once for generating a dislocation, or helping generate a dislocation study, so they could do it again, it was a non-trivial exercise, but that at least has been done before. The phasing in and the capping process would be new, and therefore, subject to all of the difficulties normally associated with systems development.

MS. NEWMAN: I understand that when Ontario, when CLEAR was introduced in Ontario there was no significant rate increase sought in tandem with that introduction, is that a fair statement?

MR. PELLY: At the time that the application was made as was required by that regulator's filing requirements, the filing to implement CLEAR was a separate filing.

MS. NEWMAN: Uh hum.

MR. PELLY: And was done on a revenue neutral basis. That was our original plan in Newfoundland and Labrador as well, but it was at the instruction of this Board that we combine the two.

MS. NEWMAN: If, in Ontario, I understand when they implemented CLEAR, they put a cap of 35 percent on it. You've already spoken to that.

MR. PELLY: That's their normal rule, which they waived in the case of Facility Association.

MS. NEWMAN: Okay, so their normal rule is the 35 percent dislocation.

MR. PELLY: That's the threshold that they use to define severe dislocation.

MS. NEWMAN: Okay, and does that ...

MR. PELLY: Plus or minus.

MS. NEWMAN: And that applies in every instance then for rate changes, or is it only for CLEAR?

MR. PELLY: Oh, this is a CLEAR issue.

MS. NEWMAN: Uh hum.

MR. PELLY: So the 35 percent is really a number that the provincial regulator in Ontario selected to distinguish extreme dislocation arising from the implementation of CLEAR.

MS. NEWMAN: Okay, could you also characterize that as an extreme dislocation for other rate impacts as well, for other dislocation, would it be fair to do that?

MR. PELLY: One can choose something comparable in any kind of dislocation situation, certainly. The provincial regulator in Ontario, to my knowledge, does not have a corresponding threshold, at least not in the public domain, with respect to general rate changes.

MS. NEWMAN: With respect to the accident benefits surcharge schedule, you mentioned the New Brunswick decision, and the discount. I noted in New Brunswick, I believe the Board found that the discount should be increased to 15 percent, are you aware of that?

MR. PELLY: That's correct.

MS. NEWMAN: If the Board here was to order that the discount be 15 percent, what would be the impact of that?

MR. PELLY: Well, depending upon how the Board rendered that ruling, it could either not, it could result in lower premiums for those eligible for the clean driver discount, but the question at hand really is whether or not the off balance factor used to calculate the base rates gets modified. In the specific case of the New Brunswick decision, their order stated that that off balance factor should not be restated.

MS. NEWMAN: So what was the impact of that then?

MR. PELLY: So they basically took the premiums that were previously being put forward, say for a risk eligible for a clean driver discount, which would have been ten percent below some published rate, and said, no, instead that's going to be 15 percent below that same published rate. In effect, whatever the approved rate level change was, it was therefore lower than what was otherwise approved.

MS. NEWMAN: Okay, I don't have any more questions.

MR. SAUNDERS, PRESIDING CHAIRMAN: Thank you, Ms. Newman. We will go now to Board questions, is that the ...

MS. NEWMAN: Normally, I think we would allow a redirect based upon ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Redirect questions.

MS. NEWMAN: ... counsels' cross examination, and then Board questions and matters arising.

MR. SAUNDERS, PRESIDING CHAIRMAN: Matters arising, okay.

MS. NEWMAN: And counsel would have an opportunity to speak to.

MR. SAUNDERS, PRESIDING CHAIRMAN: Mr. Whalen, Mr. Stamp?

MR. STAMP, Q.C.: I guess, Mr. Chairman, I just want to make sure that we have the format clear. I understand there's only one redirect at this point in time, and the panel will have whatever questions it may have, and then there will be further redirect, or further, I guess, opportunity for all counsel following that, and that's the case, I guess.

MS. NEWMAN: Yes, generally the follow-up on the Board questions relates only to matters that arose in the Board's questions.

MR. STAMP, Q.C.: Mr. Pelly, just to come back to the most recent item that has been brought to your attention, the ... I guess, the implementation of CLEAR, and specifically dealing with the New Brunswick arrangement, I understand you to say that ... I'm sorry, with respect to the surcharges and discounts, that the New Brunswick board implemented a 15 percent discount, rather than the 10 percent that was proposed?

MR. PELLY: That's correct.

MR. STAMP, Q.C.: In the filing.

MR. PELLY: Correct.

MR. STAMP, Q.C.: And it did not alter the base rates from what had previously been filed, or what was approved quite aside from the surcharges and discount arrangements.

MR. PELLY: Well, it did alter the base rates, but for reasons other than the ...

MR. STAMP, Q.C.: Yes.

MR. PELLY: ... the change made to the clean driver discount.

MR. STAMP, Q.C.: So then when it approved a rate, just leaving aside for a moment the discounted surcharge arrangements, it approved a certain rate which may have been somewhat different from what was filed.

MR. PELLY: Yes.

MR. STAMP, Q.C.: And then on top of it, it also directed that the discount be higher than had been filed for.

MR. PELLY: Correct.

MR. STAMP, Q.C.: Is the impact of that then to effectively say that the approved rates, although apparently approved at a certain level, were actually approved at a lower level?

MR. PELLY: That's the net effect of increasing the discount without updating the off balance factor, to capture the impact of that.

MR. STAMP, Q.C.: So if you were to, if the Board, for example, were to approve the rates filed and require a discount of 75 percent, for argument's sake, it would all be sort of window dressing, would it not?

MR. PELLY: I'm not sure I follow your question, Mr. Stamp.

MR. STAMP, Q.C.: Well, if you, if you raise the discount sufficiently, and I know not everybody will qualify for it, but if you raise the discount sufficiently, you will obviously impact adversely the amount of revenue you receive?

MR. PELLY: Without the appropriate balance back, yes, you would.

MR. STAMP, Q.C.: And ...

MR. PELLY: But even with, even incorporating the appropriate balance back, it raises other questions if you apply too big a discount.

MR. STAMP, Q.C.: I understand.

MR. PELLY: Given relationships with voluntary market rate levels and such.

MR. STAMP, Q.C.: Alright, so the, just to come back to what you had said in your direct examination, the surcharges and discounts were put together as a package?

MR. PELLY: Yes.

MR. STAMP, Q.C.: And would it be your opinion that it would be appropriate to modify one side of the package, whether it's surcharges or discounts, without modification of the other part?

MR. PELLY: Well, it would be my opinion that we need to capture the rate level impact of the integrated package of changes, whatever they might be.

MR. STAMP, Q.C.: And how would you do that if you, how would you do that if you ...

MR. PELLY: Well, through ...

MR. STAMP, Q.C.: ... if, for example, the Board were to direct a greater than ten percent discount, or a lower surcharge scheme than is proposed?

MR. PELLY: We would have to recalculate the off balance factor as per the examples that we referred to in my cross-examination with Ms. Newman, and incorporate that into the method of determining the proposed based rates, or the approved base rates.

MR. STAMP, Q.C.: So you go back to modifying the underlying base rates.

MR. PELLY: That would be the approved base rates.

MR. STAMP, Q.C.: So you go back to modifying the underlying base rates.

MR. PELLY: That would be the (inaudible) step.

(12:45 p.m.)

MR. STAMP, Q.C.: Now, I just want to ask you for a moment the, you were asked to look at a comparison in terms of rate increase contemplated, you looked at a class 19, driver zero rating, and a class 1, driver 5, just for the benefit of the Board, who is a class 1, driver 5?

MR. PELLY: Class 01 is a mature operator with pleasure use only, and there are some annual mileage limitations and other usage limitations of the vehicle.

MR. STAMP, Q.C.: Alright, and does pleasure use only include use to drive to and from work?

MR. PELLY: No.

MR. STAMP, Q.C.: So you don't even get to use the car to go to and from work?

MR. PELLY: Not if it's properly rated.

MR. STAMP, Q.C.: Okay, so pleasure use only, and then the driver category 5?

MR. PELLY: Driving record 5, loosely speaking, it's five years at-fault accident claims free. More precisely, there are a number of eligibility requirements where you have to have relevant experience, and I can't recite the various sub-rules from memory.

MR. STAMP, Q.C.: But a minimum of five years ...

MR. PELLY: So you would have to have been driving for five years anyway, and you would have to have been claims free for those five years.

MR. STAMP, Q.C.: Right.

MR. PELLY: And there are some requirements for Canadian driving experience.

MR. STAMP, Q.C.: Okay, and then by comparison, what is class 19?

MR. PELLY: Let me refresh my memory. Class 19 is a female principal operator, age 21 to 24.

MR. STAMP, Q.C.: And what sort of use restrictions are there in that usage?

MR. PELLY: There are none.

MR. STAMP, Q.C.: Okay, so you've gone from a mature operator driving for pleasure only, to a, I guess, not quite immature, but not the youngest youthful female driver, but somebody who is ... I think you said 20, 21 to 24?

MR. PELLY: 21 to 24.

MR. STAMP, Q.C.: Using the vehicle for any range of activities, is that what you're saying?

MR. PELLY: That's what I'm saying.

MR. STAMP, Q.C.: And that, and a driver record zero?

MR. PELLY: Loosely speaking, it's somebody who has an at-fault accident in the 12 months prior to their last renewal.

MR. STAMP, Q.C.: So we've got less than one year clean driver experience.

MR. PELLY: Well, one, less than one year of clean driving experience.

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

MR. PELLY: Just to give the Board a sense of the, the distribution of Facility Association business across the different categories of classification, if that's helpful.

MR. STAMP, Q.C.: Yes.

MR. PELLY: There's an exhibit in the rate application for private passenger vehicles in Appendix A, and as an example, if you look at page 2.1, there's a table of written, it says written exposure distribution, and across the top are the class categories, and down the left-hand side are the driving record categories identified. This particular table on page 2.1 is for the urban territories, that's the Avalon Peninsula, for third party liability arising from accident year 2000, which happened to be the latest one available at the time, and these numbers are the number of written vehicles in that particular accident year, so you can see the relative population of the various cells in this particular instance, just as an illustration.

MR. STAMP, Q.C.: So just to make sure I understand what you're saying there by reference to this particular chart, are you indicating that there are 131 exposures, i.e., vehicles, in territory one for private passenger with a driver class ...

MR. PELLY: Driving record 5.

MR. STAMP, Q.C.: Driving record 5.

MR. PELLY: 131 out of a total of 3,639, that number being the number in the sort of ...

MR. STAMP, Q.C.: On the right-hand bottom, yes.

MR. PELLY: The lower right-hand column there.

MR. STAMP, Q.C.: And that's for driving record breakdown, this is?

MR. PELLY: That's by class and by driving record.

MR. STAMP, Q.C.: Okay, so class 1, driver record 5.

MR. PELLY: That's the 131.

MR. STAMP, Q.C.: The category that was referred to you by Counsel for the Board, 131 vehicles in that category, and are you saying then there's 24 vehicles in the other category that was referred to you?

MR. PELLY: That's correct, class 19, driving record zero, and I'm not saying that there are today 24 vehicles in that category. This is from a historical period. The other point is that there is a high turnover rate in Facility Association, so even though you might measure a certain amount of dislocation from one cell on renewal, some of those people who are in there currently won't be in there on their next renewal because they'll find a home in the voluntary market, some of those people will graduate to a better driving record by virtue of having another year's claims free. Some of those people will move to a better rated class by virtue of being one year older, so there are mitigating circumstances surrounding how people's premium actually changes. I think the scenario that Ms. Newman took us through was an all-other-things-equal sort of scenario, which is fine.

MR. STAMP, Q.C.: Mr. Pelly, the discussion about dislocation and it started off to be a discussion, I guess, associated with dislocation from CLEAR, and became a discussion, I took it to be more wide ranging than that, and I think Counsel for the Board inquired as to whether dislocation could be somehow capped or set, whatever the right phrase is, for all kinds of coverage, I guess, or increases capped that way, and just for example, if the Board were to impose a cap on any one particular coverage increase and decide that somehow that was a measure of dislocation that we found that they wanted to limit the rate increase to, what would that do to your other calculations and indications?

MR. PELLY: I think the answer depends upon how the cap is worded.

MR. STAMP, Q.C.: Well, supposing, for example, that we take, you know, the class 19, driver record zero, and you told us what that rate at the moment is now, and what the rate will be if the rate filing is approved as has been presented, and whatever that increase was, or the number is, if they were to cap that increase at, for argument's sake, 50 percent, what does that do to the whole program of the rate filing?

MR. PELLY: Well, I mean if forces, it creates a situation where you don't realize the rate level that is being targeted as being needed or even proposed, but more importantly I think it creates the potential for illogical patterns of change as you pass from one rating category to another rating category by imposing caps in just some categories. The logistics for the servicing carriers of administering a plan where premiums are capped at the individual cell level, I don't want to really think about that, I'm not sure how that would be handled. I've never encountered a decision that actually imposed something like that previously. I think one needs to contemplate how this dislocation arises in the first place. You can see from the table on page one of the narrative that we are proposing an overall change of a certain percentage for a particular coverage, but it varies by territory, so some of the dislocation arises by virtue of people being in one territory versus another territory.

Similarly, within a territory, dislocation arises by virtue of people being in certain classes and certain driving records, because that's part of what influences the change in their premium from their current rates to the proposed rates. We've already imposed limitations on the swings in class and driving record differentials, as I previously stated, and is declared in the filing, so that was already there in order to try and mitigate policyholder dislocation around the average, and really the numbers that Ms. Newman had me quote represent numbers that a pretty close to the extremes about how far it can go by virtue of those caps on those swings, so if the Board is seeking to mitigate dislocation, I'm sure, well certainly if given the opportunity to comment on alternatives, we will, but I'm sure the Board's actuary will, from their own experience, will be able to talk about some of the practicalities of this particular issue. It can be very complex if you do it in an awkward way?

MR. STAMP, Q.C.: And are you implying that to attempt to impose caps in individual cells is a cost prohibitive measure?

MR. PELLY: It's a logistical nightmare and would be very difficult for the servicing carriers to implement.

MR. STAMP, Q.C.: Now, on the question of servicing carriers, you had talked about, and this was brought back to you on direct, on your cross-examination from the Counsel for the Board, that the issue of the cost of, I guess, phasing in CLEAR and I understand you to say that there's logistical features and cost features, and I'm just wondering where do these costs, where do these costs go, if service carriers incur costs for some sort of phase-in program for CLEAR, where does the cost ultimately wind up?

MR. PELLY: Servicing carriers are permitted to make application to the Facility Association board of directors for special allowances for undertaking special projects that are required of them. It's possible that they may consider the system's development work necessary to phase in CLEAR as an example of that, so there would be a special ... potentially, if the board of directors approved it, there would be a special allowance paid to the servicing carriers to allow for the systems development work that might be necessary here. That allowance would be charged to the operations of Newfoundland and so ultimately it will appear in the statement of operations for Facility Association in this jurisdiction. That, in turn, ends up being a part of the assessment/distribution process that Facility Association engages in with the voluntary, with the member companies, and that's a cost ultimately that will be incurred by the member companies, by virtue of it having been allocated to Newfoundland, so the member companies in Newfoundland would incur, would share in that cost, and in due course, more in an indirect manner than a direct manner, but that will factor into the costs of insurance for the people of Newfoundland generally.

MR. STAMP, Q.C.: And that's the 96 or whatever percent who are not insured through Facility.

MR. PELLY: That's correct.

MR. STAMP, Q.C.: Now, you mentioned the assessments and distributions to and from members and I want to come back for a moment, just this last topic, and this is a chart that was shown to you by the Consumer Advocate. It is, I think he indicated, Tab 4 to Mr. Morris' pre-filed evidence. Do you have that before you?

MR. PELLY: I have that.

MR. STAMP, Q.C.: Just so I can get your sense of this chart, Mr. Pelly, I gather what has been done is there has been a cumulative calculation of the, what appears to be net profit from the years of operations 1986 through 2001 at some $21,800,000, is that right?

MR. PELLY: I see that number, yes.

MR. STAMP, Q.C.: And is that what you anticipate, is that what you understand this chart depicts?

MR. PELLY: Well, I think the net result from operation profit, bracket, loss, is a number that gets extracted from the statement of operations of Facility Association for each of those years.

MR. STAMP, Q.C.: And then I gather what has been done has been that an estimate of certain member company expenses has been charged out of that and specifically it appears that they've charged out premium taxes and health levies estimated at 5.5 percent.

MR. PELLY: So that was an estimate of the costs incurred by member, by member companies on behalf of Facility Association.

MR. STAMP, Q.C.: Which I believe you said in your earlier evidence was a direct cost to them.

MR. PELLY: That's correct.

MR. STAMP, Q.C.: Paid directly by the member companies.

MR. PELLY: That's correct.

MR. STAMP, Q.C.: So that comes out of whatever, $9.8 million, and brings that otherwise, the other ... the surplus or ... before the deduction of that amount down to about $12 million, is that correct?

MR. PELLY: I see that, yes.

(1:00 p.m.)

MR. STAMP, Q.C.: Now, you had mentioned, I think it was in your cross-examination with the Consumer Advocate that your understanding was that the operations, you may have said to September, into September 2002, it appeared to indicate a deficit of some $5.7 million?

MR. PELLY: That's my recollection.

MR. STAMP, Q.C.: So that, if that holds true to the end of the year, it may even be higher, we don't know, but that would bring the $12 million down to something in the order of $6 million.

MR. PELLY: Approximately.

MR. STAMP, Q.C.: Alright, now the expenses that are referenced in the deduction of the $9.8 million premium taxes and health levies, are there other expenses to your knowledge that have not been mentioned here?

MR. PELLY: There are a few. A fairly minor one would be some of the other kinds of industry assessments that get applied to, on the basis of direct written premium. This would be certain kinds of assessments from the Insurance Bureau of Canada on its memberships, from various regulators on the industry. There are several different assessments that get applied as a percentage of premium, so those aren't captured in this number. I don't know about the basis for the 5 1/2 percent, so I'd certainly want to explore that if you wanted to make this rigorous because the various percentages that get applied for premium taxes have changed through time, and of course, the health levy hasn't existed throughout time either, so using an average like this is potentially fraught with difficulties.

Over and above that, this doesn't capture consideration of income tax ... when a net positive result from operations for Facility Association flow into a member company's books, that has tax consequences as does a net loss on operations, so there are tax consequences up and down. And finally it doesn't really capture the concept of cost of capital. These member companies are required, at least notionally to allocate a portion of their capital to support the operations of Facility Association in this jurisdiction, and in fact, in all jurisdictions in which Facility Association operates and as with any kind of enterprise, there is a cost associated with that capital which is not, not reflected in this calculation.

MR. STAMP, Q.C.: Alright, so just those additional costs which don't appear to be discussed here, if we take the numbers looking as they do for the current fiscal year, you're down to something in the order of $6 million of surplus, and that appears to have developed over a period of, I don't know how many years, '86 through 2001, during which time there are about roughly $179/180 million of total premiums. Now, by my calculation that's a surplus of something just over three percent over that period.

MR. PELLY: You'd have to add in the current year's written premium as well in order to ... because you pull that in, that result from operation which would just increase the premium.

MR. STAMP, Q.C.: So another $11 or 12 million perhaps there.

MR. PELLY: Yeah, well the $5.7 million that we have is a year to date number, but it's a relatively small value compared to the long-term history in my view.

MR. STAMP, Q.C.: Okay, and one last feature of this chart, I want to just, and I'll just give you an example, I won't go into the whole thing to try and sort of figure out the timing of it all, but I notice that the first distribution, the first assessment or distribution, either one of them, seems to have occurred in the first year, or I'm sorry, in the fourth year, so it looks like it was 1989.

MR. PELLY: I see that in this chart in the last column.

MR. STAMP, Q.C.: Yeah, and so there was a distribution after four years of operations, or in the fourth year of operations, to the member companies, but just to go back to the discussion about the companies' expenses being incurred directly by member companies, I presume that with the distribution that arises four years into the process, that there is a time lag on returning expense money to the members that's been incurred in the first four years of operations.

MR. PELLY: That would be the case, yes.

MR. STAMP, Q.C.: And would you see anything in this chart to indicate that that's been taken into account?

MR. PELLY: Not in any obvious manner. I mean that time lag, if there is an assessment, ultimately that time lag does give rise to investment income by virtue of there being dollar amounts being held in Facility Association that are targeted for distribution to members and that investment income flows into the net result of operations in the particular period when that investment income is earned, so it's, there is a number sort of buried within here that has captured to some extent the time value of money issue *(phonetic)*.

Having said that, the match in the last column with the preceding columns is always going to be imperfect. There are, through its history, Facility Association has followed different practices with respect to assessments and distributions of its member companies, and that was discussed in some detail at the previous hearing. Originally they waited until the policy year was five years old before making the first distribution. I think that changed to something more recent when they changed to an accident year basis for distribution, and the latest ... or assessments ... the latest assessment and distribution notice went out and it incorporated the most recent accident year as estimated up to a point in June, I think, of this year, so there have been changing practices, that's my point, and the timing of a particular assessment or distribution doesn't necessarily bear a logical relationship with the numbers to its left, although on a cumulative basis, it is what it is.

MR. STAMP, Q.C.: Perhaps I could ask you this way, on that last aspect that we've been talking about, perhaps I can ask you this in a more general way ... would you rather have a million dollars or be owed a million dollars?

MR. PELLY: From a personal perspective, I'd rather have the million.

MR. STAMP, Q.C.: That's all the questions I have, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: Thank you, Mr. Stamp. Mr. Martin?

COMMISSIONER MARTIN: I have no questions.

MR. SAUNDERS, PRESIDING CHAIRMAN: No questions, Mr. Powell?

COMMISSIONER POWELL: Yeah, I have a few questions. You don't give an accountant all these figures and not expect him to ask questions ... just have to wait for a few moments. I was making notes as I've been going here and some of them have been answered, so you'll have to bear with me.

One of the things I'd like ... you used a number of terms and I probably don't want to show my ignorance of the thing ... when you say base rate, what do you mean by that, give the higher view of that or simplistic view, if you can?

MR. PELLY: For a particular coverage in a particular territory there is a base rate. That base rate is the centre point upon which all of the rates for all of the different rating cells for that particular coverage for that particular territory are linked, to which they are all linked, and they're linked by use of, say, class differentials or driving record differentials, or limit differentials or rate group or deductible differentials, all of those differentials explode a base rate out to be an array of premiums for all the different rating categories that exist.

COMMISSIONER POWELL: So if we had a territory and if everybody was the same class, the same record, you had a certain volume of costs, you divide it and everybody's record would be the same, but of course, we don't have everybody of the same class, the same ... and you start (inaudible) out. Okay, I sort of thought that's what it might be, but that's based on territory, not for the whole province.

MR. PELLY: There's base rates by territory, by coverage.

COMMISSIONER POWELL: How are costs assigned? We have in the province three territories. I'm living in territory one, I have an accident in territory two, how is the allocation made?

MR. PELLY: To the extent that claims arise on your policy those claims will be allocated to territory one, if you are rated as being in territory one, which would be the case, given that, it sounds as if that's where you are principally garaged, which is the rule that gets used for allocation, assignment to territory.

COMMISSIONER POWELL: So two people from territory one happen to be visiting territory two, have an accident, that all shows as if the ...

MR. PELLY: That, both of those policyholders, if the total amount of claims dollars that were incurred arising from that accident, all arise on their two policies, then those, all of those costs will be incurred as territory one costs, and the logic there is that they are the party either responsible or, well between the two people, they are the party, one of them is the party responsible throughout.

COMMISSIONER POWELL: One of the schedules you had sort of intrigued me a bit, it was your BGP-4, that's the one, the comparisons of premiums written to industry versus FA market share, and it showed Newfoundland, and we have '96 to 2000 and the other provinces and Ontario. If we, the panel approves the application as presented, where along this chart will we be approximately now?

MR. PELLY: That's a challenging question, sir. It's challenging because the market evolves, and the immediate effect will be the movement in the relationship between average premium, Facility Association average premium to industry average premium. I mean if you take the status quo as being the starting point, and you increase Facility Association average premiums by some 40 percent, say for private passenger vehicles, then clearly that relationship has changed. The minute you start issuing policies under that new world, that new rate level, that relationship is going to start to change. And that will move Newfoundland to the right, but the other thing that will happen is the market will respond to that opportunity ... opportunity in the sense that it maybe creates room for more non-standard markets, more ... my apologies, more non-standard market companies to come and participate in the opportunities that exist in Newfoundland and Labrador, and if that's the case then industry average premiums may change too, and I can't tell you what direction they'll change, to be honest, but they may change.

Business may flow out of Facility Association by virtue of the presence of some non-standard carriers, and it may also flow into normal voluntary market companies as well because there are cases now where there's a counterintuitive relationship between Facility Association rates and voluntary market rates, so it's a dynamic process. I would say the general direction that it's likely to move is down and to the right, but it will evolve, it's not an overnight jump.

(1:15 p.m.)

COMMISSIONER POWELL: So it's sort of, looking at the schedule and what you said, I had it broken down into two separate questions because based on what counsel for FA said, FA's ultimate goal is to be zero, so you look at this schedule here, Ontario's got it down to one percent, and I think ... or less, and they're 350 percent of normal premium. So very simplistically you say, well, why don't FA come in with an application showing the rates and (inaudible) 350, we'll go to one, but that's sort of like using the bulldozer to move a shovel of snow, so I guess my question is how does this application get us to one percent? I mean just by increasing rates for the 40 percent, will that just get all the consumers running and get all the insurance companies, or I mean has this got to be, it's got to be more of a plan than just kick the fellow and go ... so how do you address that from an actuary's point of view? I realize that you're only one part of it.

MR. PELLY: We don't actually create this result.

COMMISSIONER POWELL: No.

MR. PELLY: This result just happens. Our objective in putting forward indications is to identify rate level need and the rate level need in Ontario is in the order of magnitude that is reflected in the realities of the relationship with the premiums. The rate level need in Newfoundland doesn't appear to be as extreme given the 40 percent. Now having said that, there are mechanisms in place in the rate making model where we temper the speed that we react to the claims experience and it's conceivable that if we allow movement towards, substantially towards the indications and we get that body of experience giving rise to claims for a period of time, we may find that the worst of the worst are worse than we thought, and that's one of the realities of the way this, this mechanism works. You can only work with the experience you've got, and you do the best you can to build up an expectation for a future rating period. So it may gradually evolve beyond what today's application might suggest it would but having said that, we're currently at about 170 percent of industry average rate levels if you look at this chart now.

COMMISSIONER POWELL: I had it worked to 175 in my schedule.

MR. PELLY: Okay, and if we're applying for a 40 percent increase on top of that, we'd expect to be up in the neighbourhood of 250 percent. Now it's not going to jump there overnight because other things happen, but that would be where your appriori *(phonetic)* expectation might be, where you might end up, so that's a substantial jump over towards the right hand side, and my expectation would be that there would be a significant extra heightened level of activity in the non-standard market that would eventually come to take some of that business out of Facility Association. I mean that's been what's happened in other jurisdictions.

COMMISSIONER POWELL: So my other question actually is better addressed to the director of the FA in terms of how they in the insurance industry intend to get us to come down the chart. I mean you're saying we should move this way based on the actuarial evidence, so to give some comfort to ourselves, if we were to approve the increase, we'd almost need to have some sort of comfort insurance that we were going to go down the ladder as opposed to going across, and I mean I think it's sort of agreed that they who cause the accident should pay for it, so therefore, I presume this is what's happening in Ontario with the 350 percent over the ...

MR. PELLY: Well, the experiences ...

COMMISSIONER POWELL: Because they're more severe, the bad ones are even worse than you thought.

MR. PELLY: Well, they're pretty bad, yes, compared to industry. Neither does Facility Association control the action of the non-standard carriers who currently are not choosing to operate in, some of them are choosing not to operate in this jurisdiction. Now, the obvious question is why do they choose not to operate here, well part of the regulatory barriers, and part of it is also the relative position of Facility Association rates to the voluntary market. If they don't feel they have enough room to build a critical mass to justify entering this market, then they will choose not to enter the market.

COMMISSIONER POWELL: Well on issuers of policies in this market are automatically FA.

MR. PELLY: Well, anything that is issued by a servicing carrier is a Facility Association policy.

COMMISSIONER POWELL: But you've automatically got to be involved in FA if you're into the market, right? The ones you're talking about are not here so therefore they're not involved with FA here. They may be ...

MR. PELLY: But I mean in a province like Ontario, admittedly we've got a bigger population base in Ontario so that makes a difference too, and I don't want to make that, hide that fact, but there is, I'm not sure ... the Board actuary would probably be in a better position than me to say roughly how many companies are, are active as non-standard carriers in the Province of Ontario, but I think there's at least seven or eight.

COMMISSIONER POWELL: Yeah, those providers, they would fill the gap, and they wouldn't put anybody in the FA because ...

MR. PELLY: Well, they would put only the risks that they're not prepared to write into the Facility Association, or they would decline, they wouldn't put them there, but they would decline to write those policyholders and some of those policyholders will ultimately find their way ...

COMMISSIONER POWELL: The point I was trying to make, everybody that's selling insurance has option to put someone in the FA. If I came in and I didn't fit into their criteria, they, if I wanted insurance from them, the alternative is to go into the FA.

MR. PELLY: Well, if you go to a broker who represents five companies ...

COMMISSIONER POWELL: Uh hum.

MR. PELLY: And if that broker cannot find a home for you in any of those five companies, that broker also represents Facility Association and they, the broker may offer you coverage through Facility Association, but as a consumer you always have the right to shop around.

COMMISSIONER POWELL: One of the other ... I'm intrigued by this idea of whether Facility makes a profit or doesn't make a profit, in fact in page 10 of your filing you break things down into the expenses and underwriting margins, and there's been a lot of discussions about for profit, and Facility doesn't include a profit margin in the rates. When I read that I had sort of difficulty, and again, I'll talk to the director of FA more when he comes, but from an actuary's point of view, you're going out and you're setting rates based on all different, the cost of claims and things like that, and in a normal market, wouldn't there be a profit factor, just like the ... there's some reference there about return on capital ... these are normal things, so I'm a normal insurance person in the sense that I have no accidents, I'm paying my premiums and I'm happy to pay them because, you know, insurance is one of those things you complain about the rates but you never want to find out how good or bad it is because you never want to have an accident, so you know, we accept that and it's part of the service, but the message I'm getting from this here, those were deemed to be the most risk, the ones that are causing the volatility in the market and everything else ... they get rates without any of these costs built in. From an accountant I find that difficult. I mean from an actuary, I mean ...

MR. PELLY: Well, you started by asking about, referencing what might be normal practice in the voluntary market, and normal practice in the voluntary market is to include some kind of a profit provision which includes consideration of a return on capital. The issue of the profit provision to be included in the rate applications has been revisited by Facility Association's board of directors on a number of occasions through its history and the board has representation, substantial representation from the insurance industry, so they're well aware of the very point that you're making, that there is a cost to the industry for supporting the operations of Facility

Association inherent in not making provision for the cost of capital, or a return on capital in the rate indications. They have done that knowingly and with the plan of revisiting the decision periodically.

I'm not sure that I can speak to the rationale for that decision other than to say that it's recognized that it's a choice that they make and it's not an easy choice for them to make but I suppose in some respects it has elements of affordability and it has elements of going back to the origins of Facility Association. When it first started, when Facility Association first started up in several jurisdictions, we didn't have a particularly good handle on how much, how far is the ideal distance out on this table, how high should Facility Association rates be relative to the voluntary market. When it was first started in Ontario, in the absence of any experience, the regulator chose a level of 2 1/2 percent, so their position was that, in Ontario, that Facility Association premiums should be on average 2 1/2 percent higher than industry premiums.

Needless to say that 2 1/2 percent has proved to be considerably off the mark, but that gives you an idea of how, how little was known about how bad was going to be the experience of the residual market. We now have the benefit of a lot of claims experience, and as we move closer and closer to what we identify as being rate adequacy, the issue of return on capital is again an issue. Also the practice of, or the performance in the voluntary market as capital becomes more scarce ... I'm sure the issues of the return on capital supporting Facility Association is an emerging issue for the industry as well.

COMMISSIONER POWELL: Speaking about return on capital, that's the other thing that sort of, I find it difficult to get my mind around. You look at the, Mr. Morris' evidence, there's copies of Facility's balance sheet, and October the 31st, 2001, with comparisons, 2000. Again, I appreciate that you're an actuary and you're not a financial statement person, and I'm, but I'm sure you must appreciate how balance sheets work, you know, you have your assets and you have your liabilities and you have your capital, and because Facility is sort of a non-profit, and they tend to have a little different configuration, but up in the assets section there is an amount due from members, and it's $250 million. In accounting terminology that would be known as negative capital and so really as the insurance industry getting a return on the capital, you would think the Facility Association, there should be a factor, you know, of lost revenue put into that and sort of a negative return and that represents on $775,000, quick math, one third of the total assets, or total liabilities of the Facility, so again, I get this, what are they trying to do type thing, and I mean from an actuaries point of view, when you look at that and you say, okay, they got a negative capital, so shouldn't I be factoring ...

(1:30 p.m.)

MR. PELLY: You might be helped by looking at the financial statement that's at Tab 3 instead of the financial statement that's at Tab 2, and the difference between these two is that the latter, the one at ... sorry, well anyway, the one at Tab 3 is restricted to strictly the residual market segment of Facility Association. The statement at Tab 2 is inclusive of a sharing pool in Ontario and the uninsured auto funds in, I think, the four Atlantic jurisdictions, so you might, if you restrict your view to the Facility Association residual market, that might take you a step of the way towards getting a better handle on, on the particular issue that you're focusing on right now.

COMMISSIONER POWELL: The other thing in this balance sheet, you show a provision for unpaid and unreported claims. Again, we'll go back to the main balance sheet, just it shows $620 million and 640 for the previous year. This is, I gather, a figure that's put together by the claims department, the appraisers. As an actuary, you're consulted to vet *(phonetic)* this type of figure to see if, based on the history and go-forward, whether that's realistic. I gather that's ...

MR. PELLY: There is a component of the unpaid claims provision that arises from the work of the claims adjusters on the individual claims, so they place an estimated value on their expectation for the ultimate cost of claims and claims related expenses on a claim by claim basis, and that's a portion of the $620 million that appears here.

Another significant portion of it is a number estimated by Facility Association's valuation actuary and this is the provision for the cost of claims above and beyond the estimates on an individual claim-by-claim basis. This is what we refer to as a bulk provision for unpaid claims or sometimes it's called IBNR for incurred but not reported. Neither of those names is terribly descriptive, but in a nutshell, it's intended to provide for development on known claims beyond the level expected by the case reserve, set by the case reserve, by the adjuster, or the emergence of late reported claims that are not currently known and for on which there is no current case reserve. Either of those two phenomenon give rise to a need for this bulk provision, and the actuary's job is to make an estimate of that number at a given point in time, doing a process not unlike what we do in rate making in terms of analysing loss development, but with a slightly different ultimate objective.

COMMISSIONER POWELL: And these are very subjective, if you had three actuaries, being off five percent plus or minus wouldn't be a ...

MR. PELLY: It wouldn't be uncommon.

COMMISSIONER POWELL: It wouldn't be uncommon.

MR. PELLY: No.

COMMISSIONER POWELL: And so really those figures there, and that really impacts on your statement of operations because the changes in that goes into that, when you talk about the expenses of the insurance pool, is that the claims and claims expense incurred? Like if that figure ...

MR. PELLY: Yeah, it flows through the claims and, expenses incurred number.

COMMISSIONER POWELL: So if that's off five percent one way or the other, and based on 2001, you're looking at $30 million plus or minus ... either you're that much better off or that much worse off.

MR. PELLY: That's conceivable. The work of Facility Association's valuation actuary is very closely scrutinized by the Facility Association actuarial committee on an ongoing basis throughout the year. There are, in addition to the reserving analysis that underlies the financial statements, there are quarterly reviews that are done throughout the year so that the emerging claim experience is monitored on an ongoing basis throughout the year by both the valuation actuary and by the actuarial committee.

COMMISSIONER POWELL: So there is a consistency in how you do that, I mean in terms of, your methodology.

MR. PELLY: It evolves, it seeks to respond to emerging issues, but the methodology remains relatively constant through time, subject to enhancements that are introduced periodically to improve the, either because new data become available or a new issue arising which needs special treatment.

COMMISSIONER POWELL: Because this figure here, and all your figures, I mean this ... using these statements and I ... I'll use the term loosely, but this figure here more than anything else will show whether you had a profit or loss for the year. This is like the inventory of a large, a lot of companies in terms of if you change the method in which you account for, you change the method in which you value it, you have a big impact in your bottom line, but over a period of time, it really doesn't matter because it will work itself through. As you said the other day, I think, the last claim is paid the last day of Facility, you should end up with zero dollars.

MR. PELLY: That's the objective of the rate making philosophy. The statement at Tab 2 here is an all inclusive statement. The statement at Tab 3 is just the residual market portion, but in both cases they encompass all jurisdictions as well. But I don't disagree with your point that when you are trying to assess the operating results of Facility Association, that the income statement then is a good guide to that. What is difficult is to draw conclusions about the adequacy of rates in an individual jurisdiction armed with only this information.

COMMISSIONER POWELL: And it's not really intended, like what I found difficult listening and reading it all is that, you know, you're an actuary, you're doing your job, and you make these judgements, and like anybody, any profession, you make judgements, sometimes you're wondering whether they work out. It's always nice to be able to go back and look, but you can't really get it from the financial statements of Facility. I mean it's almost two different ... there's a familiarity or similarity (inaudible), they never really ever work out, and we know the probability of the day that Facility Association, the last dollar and last claim, that's a theoretical type thing as opposed to an actual ...

MR. PELLY: You get a sense of how experience actually evolves when you do the work though. A simple example would be in the trend analysis. We include as part of our trend analysis a run of the prior year's model, so that we see how all, like all we've done is updated the data, and we've run the previous model using new data, and how has the annual trend factor assumption changed, just as a result of that, and then we start tinkering with the model in order to try and improve it using the experience to date, so you can get an assessment of how good a job you did at the component level. It is difficult to get an assessment of how good a job you did in the grand scheme, like overall, particularly across all jurisdictions and classes of vehicles.

COMMISSIONER POWELL: It's a good place to end for the day.

MR. SAUNDERS, PRESIDING CHAIRMAN: Did you have other questions?

COMMISSIONER POWELL: I may have ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, well we're ... it's 20 minutes to 2:00, we're a little past our scheduled time for adjournment for the day, so what's the ...

MS. NEWMAN: I haven't talked to the parties, Mr. Chairman, in terms of our storm protocol for tomorrow, but what I would suggest is that perhaps we have a later start in the morning. I don't know ... a 9:00 a.m. start may be difficult for everybody, including the transcriber and staff, to get in here if the weather is still messy. I'd probably suggest that counsel advise the Board Secretary as to where they may be reached in the morning in the event that we simply can't open, can't proceed, and we can contact them.

MR. SAUNDERS, PRESIDING CHAIRMAN: Well, how about if we left it this way, that we'll proceed on schedule at 9:00 unless there's some problem, and if there's a problem, we'll all know about it. I would assume that then we'll get in contact with each other if there's anyone that doesn't show up and see where we go from there. Otherwise, I hate to put any reliance on the forecast saying we're going to have 30 centimeters of snow, because it's only right 50 percent of the time, and you can get that accuracy with a coin. So we'll adjourn now for the day and we'll come back in the morning, and I think Mr. Powell may have some more questions and I don't think I have any at this stage, unless something comes to me overnight, so it will be back then for questions arising from Board questions. Thank you.

(hearing adjourned to December 18, 2002)