(9:45 a.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: Good morning. Everyone is accounted for. We're a little late starting this morning, by about 45 minutes. If you wish we can add some time on to the end of the morning, meaning we can go beyond 1:30 if that's your wish. We might have to make some arrangements for a snack or something in between but that can be done as well if you need, so I just offer that. And any preliminary matters, Ms. Newman?

MS. NEWMAN: No, other than, I guess, if we're going to stay a little longer we should probably make the arrangements now given the weather. I don't know if people want to speak ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Well, I thought maybe we'll have our first break this morning, I would think, around 11:30, and we can decide then and make some arrangements for 1:30 or 1 o'clock or sometime like that.

MS. NEWMAN: That may be difficult to ... I'm told it may be difficult to get anything within that short time frame, especially in light of the weather.

MR. SAUNDERS, PRESIDING CHAIRMAN: Well then, maybe you'd better canvass the group here now and see what their wishes are. First of all, do you wish to go beyond 1:30? Some of you may have other commitments, I don't know.

MR. O'FLAHERTY: Yes, Mr. Chairman, I do have another commitment.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. Well then, that pretty well deals with that.

MR. O'FLAHERTY: But I am prepared to see if I can rearrange it if it's, you know, if it's convenient, but that's the situation at present with me.

MR. SAUNDERS, PRESIDING CHAIRMAN: How about you, Mr. Whalen, Mr. Stamp?

MR. WHALEN, Q.C.: Well, I mean, I think if we have to start rearranging things, that's going to take more time.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yeah.

MR. WHALEN, Q.C.: Why don't we just carry on and go till 1:30 and ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MR. WHALEN, Q.C.: If that's ... unless somebody really wants to press on.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. So we'll go to 1:30? Alright, so we'll go until, say, 11:15, 11:30, for the first break, whenever it's convenient. Any other preliminary matters, Ms. Newman? Good morning, Mr. Pelly.

MR. PELLY: Good morning.

MR. SAUNDERS, PRESIDING CHAIRMAN: I think ... I was wondering if actuaries get involved in forecasting weather.

MR. PELLY: Not routinely.

MR. SAUNDERS, PRESIDING CHAIRMAN: Not routinely.

MR. PELLY: To my knowledge anyway.

MR. SAUNDERS, PRESIDING CHAIRMAN: Mr. Powell, you had some further questions?

COMMISSIONER POWELL: Yes, Mr. Chair. We got a little bit of divine guidance on this one. I had a note and I missed it but when I was going through this morning I had a note made, you used the expression harsher claim environment. When I woke up and saw the weather, harsh came to me, so I just wondered could you expand on that? You used that a number of times during your testimony.

MR. PELLY: That was a phrase that I was trying to use to capture the general claims environment that is, the way it's evolved of late in Newfoundland and Labrador as well as other Atlantic jurisdictions and to some extent in tort jurisdictions across Canada. There is a more litigious atmosphere in terms of the aggressiveness by which claims are pursued, particularly tort claims are pursued, and generally speaking awards are escalating at a more aggressive rate than has been evidenced in the more distant past, but from a claims development standpoint, which is where I was bringing that up primarily, in the, say the last two, three or maybe even four calendar years, the patterns of development on the tort claims are steeper

generally. They are growing at a faster clip in terms of the development on reported claims.

COMMISSIONER POWELL: Actuarially, is there any statistical thing to show why or is that just a trend that'll, bubble will burst and come down?

MR. PELLY: Yeah. I'm always hesitant to use the word trend because that confuses the concepts of loss development and trend but in a sense it is a trend, it's a pattern anyway. There is ... you can use industry data to get more stability to demonstrate the more aggressive claims environment that's prevalent these days, so there is experience that does provide a demonstration to that. The Insurance Bureau of Canada did undertake a number of closed claim studies for different regulators in Atlantic Canada in the last year and a half or so. The purpose of using closed claim studies is to avoid the uncertainty that's prevalent with respect to open claims and the premise of using a closed claim study is to observe where the claims dollars are being spent and how that cross-section of the claims dollars is changing through time. Generally speaking, and I haven't reviewed them recently, but my recollection is that their finding was soft tissue injuries primarily that were the driving force behind the growing emergency of tort liability claims and there was a, you know, a significantly enhanced involvement in claims involving legal counsel and that there ... I mean, it's just a phenomenon that the insurance industry is having to cope with.

COMMISSIONER POWELL: So some of the claims would (inaudible) advance medical techniques in terms of identifying injuries that may have already been there, that sort of thing or ...

MR. PELLY: Well, the specific Insurance Bureau of Canada Study I believe was focused on tort claims and in terms of, I don't recall there being any reference specifically to advancements in medical science. I think it was more a case of the willingness and the desire of claimants to pursue their potential indemnification more aggressively than perhaps has been the case in the past.

COMMISSIONER POWELL: Another term that you used and I made a note when you were giving your evidence and I didn't note exactly where, but you used the expression favourable run-off. What would a layman expect, take from that?

MR. PELLY: This concept arises in the context of loss development and specifically as an observation of, in the case of our application anyway, in the observation of how accident year reported incurred losses have evolved through time. Favourable run-off and adverse run-off are opposite phenomenon, and the environment that we're in right now is characteristic of adverse run-off where we have an increasingly harsh claims environment. Favourable run-off occurs when case reserves are established by claims adjusters at a time on the basis of best estimate of ultimate cost of claims and actuaries build a provision, this bulk provision for the development on known claims, further development beyond the case adjuster's estimates, plus a provision for unreported claims. Those estimates are established at a time based on the information that's available at the time on a best estimate basis but they prove to be more than adequate, so with the passage of time that cohort of claims for a particular accident year evolves more favourably than was anticipated at the time, at a particular point in time, and a general descriptor, that can be described as favourable run-off, run-off in the sense that you have an estimate of the ultimate cost of claims at a particular point in time and as you go forward from that point in time it proves to be significantly more favourable, if I can use that word again, than was anticipated earlier.

COMMISSIONER POWELL: Okay.

MR. PELLY: When it's used as a descriptor of an environment, it's not limited to a single accident year. It's a broader phenomenon so that it's encompassing several accident years.

COMMISSIONER POWELL: Just to go back to your chart, BGP-14, *(sic)* where you do the comparisons of FA premiums written and, in the province and other jurisdictions, and particularly Ontario, which is the, from this chart would be the more favourable as a percentage of total business, my understanding ...

MR. SAUNDERS, PRESIDING CHAIRMAN: You mean BGP 4.

COMMISSIONER POWELL: BGP-4. It's my understanding, you may correct me if I'm wrong, Ontario, they have different rules for placing policies in FA than we do here in the province?

MR. PELLY: In a nutshell, yes.

COMMISSIONER POWELL: And would ...

MR. PELLY: There's another difference as well in that Ontario has a mechanism in addition to Facility Association called the risk sharing pool, which is a mechanism that's available for insurers to use on a limited basis for placing risks and sharing the results on risks that they don't want to accept to their own book and they concede a significant portion, I think it's 85 percent of the exposure on a particular risk, to the risk sharing pool and they have to retain 15 percent for their own book, and the results of the risk sharing pool are shared over the industry as well, in Ontario.

COMMISSIONER POWELL: Are those the, inherent in those financial statements ... there's reference on risk sharing, are those the ...

MR. PELLY: You'll recall there are two sets of financial statements in that book. The set at Tab 2 are inclusive of the risk sharing pool, the administration of the uninsured auto funds in the Atlantic Canada provinces as well as the residual market mechanism known as Facility Association residual market in the various jurisdictions in which that operates. The financial statements at Tab 3 includes the Facility Association residual market and the uninsured auto fund, but not the risk sharing pool, so the big difference between those two is the Ontario risk sharing pool.

COMMISSIONER POWELL: So if we added the Ontario risk sharing pool to the FA, where would that put the Ontario (inaudible) Newfoundland?

MR. PELLY: Into that chart on BGP 4?

COMMISSIONER POWELL: Yes.

MR. PELLY: Well, one of the other features of the Ontario risk sharing pool is that the premium that is charged for a risk seeded into the pool is whatever premium the insurer originally provided the coverage to as a direct insurer of that policyholder, so there is no other rate level. It is only the voluntary market rate level that's used as the basis for charging risks that are placed in the risk sharing pool that distinguishes it from Facility Association which has its own independent rate level, so if you included the Ontario risk sharing pool in that graph, the average premium of the risks seeded into the risk sharing pool compared to the industry average premium, would probably be greater than one. That ratio would probably be greater than one because of the risk characteristics of the, or the rating characteristics of the policyholders placed in the risk sharing pool typically, but it would be nowhere near as high as the average, that ratio that exists for Facility Association, so I would say that would pull the point to the left, and given that there is a significant block of business in the risk sharing pool, I'm not sure that I can quote market share right off the top of my head, but there is a fairly significant block of business in the Ontario risk sharing pool that would pull the data point up.

COMMISSIONER POWELL: Four or five percent, when you say significant, or would it be that high or ...

MR. PELLY: I'm hesitant to give you an answer on that off the top of my head. It's a number that's certainly available but I can't quote it.

COMMISSIONER POWELL: Could you attempt to get that for us, please?

MR. PELLY: I can do that.

COMMISSIONER POWELL: One of the intervenors that we're going to hear from later on, I think they're scheduled to make public participation days, are the taxi operators. They are in the FA?

MR. PELLY: There are taxi operators in Facility Association.

COMMISSIONER POWELL: But they're not globally ... not all taxi operators are in FA?

MR. PELLY: It's typically ... in a lot of jurisdictions it is a higher market share of, higher percentage of taxis are insured through Facility Association compared to, say, typical private passenger vehicles, that's not uncommon, but there are ...

COMMISSIONER POWELL: In Ontario would they be more in that risk pool as opposed to FA?

MR. PELLY: I'm sorry, I don't understand the question.

COMMISSIONER POWELL: You described previously about in Ontario they have a risk pool as opposed to FA coverage in addition, a ...

MR. PELLY: The risk sharing pool.

COMMISSIONER POWELL: Risk sharing, excuse me.

MR. PELLY: Okay.

COMMISSIONER POWELL: Would taxis be more inclined to be there as opposed to FA?

MR. PELLY: No. The risk sharing pool is limited to only private passenger vehicles.

COMMISSIONER POWELL: Okay. So you're either on a general insure carrier or into the Facility ...

MR. PELLY: Facility Association.

COMMISSIONER POWELL: Is there a market in between? Is there another ...

MR. PELLY: Well, there are non-standard writers, several of them active in the province. I can't say I have enough familiarity with the details of their operation to know whether or not they're active in the taxi market.

COMMISSIONER POWELL: One other question. On page ten of your pre-filed evidence, 2.7, you talked about the expenses, underwriting margins, and the last paragraph says, "As was done in the previous private passenger filing, a provision is made for the health level and the liability indications through an adjustment to the expense provision rather than the loss loading." What do you mean by that?

(10:00 a.m.)

MR. PELLY: When the Insurance Bureau of Canada publishes industry experience exhibits, the AIX exhibits that I referred to, in Newfoundland and Labrador as well as the other Atlantic provinces and in Alberta, where there's a similar concept to the health levy, they publish the claims dollars to include a factor to allow for the cost of the health levy, so in effect the health levy charges are treated as part of the claims experience, and the rationale for doing that is sound in that the health levy concept was introduced in each jurisdiction to replace a subrogation process that used to exist prior to the health levy, subrogation process of the provincial Ministry of Health or whatever the correct local title is, against the insurer of innocent victims of automobile accidents so that if there was an indemnity, if a victim of an automobile accident needed health care and the health system incurred costs prior to the introduction of the health levy, the Ministry of Health would subrogate against the at fault party's insurer for the cost of that health care. That was a case by case and fairly costly process, as you can probably imagine. One jurisdiction at a time adopted an approach of replacing that with a health levy so that subrogation would stop and would be replaced by a health levy which initially in principle was established to approximate the same costs to the insurance industry as was originally being experienced under the subrogation process. So because it's replacing a claim, an amount that was previously treated as a claim, the Insurance Bureau of Canada continues to put it into the experience as a claim and loads the losses accordingly. We choose to strip that out of the industry data and not include it in the Facility Association data on that basis, and the reason for that is that we're finding that the health levy, the dollars of health levy amounts are not escalating at the same pace as is the case for the underlying cost of claims, and accordingly if we include it with the losses and apply trend factors, say, to a loss cost that's inclusive of the health levy, we are in effect forecasting the health levy to grow at the same rate as the underlying loss costs, and that we found to be an overstatement, so we stripped it out and we treated the health levy as an expense component rather than as a claim component.

COMMISSIONER POWELL: Well, I follow your argument. When I read it, I was trying to interpret this data with some of this data in terms of I looked on the liability as a balance sheet item and an expense as an operating cost. So you're talking about actually taking it from an actuary point of view ...

MR. PELLY: The health levy itself never arises as a payment obligation of Facility Association. It arises as a payment obligation of member companies, and they, when they are assessed by the Minister of Health or the appropriate minister, that assessment is inclusive of that member company share of Facility Association, so the health levy, like premium tax, is one of those items for which a provision is needed in the premium but for which Facility Association itself does not directly incur the expense but rather the member companies incur that expense on behalf of Facility Association.

COMMISSIONER POWELL: Because it's a pass through cost, right, in the sense it's built into the premium because (inaudible) ...

MR. PELLY: It's a pass through cost. It's a component of premium ...

COMMISSIONER POWELL: Premium, but ...

MR. PELLY: ... and there's an assessment on the industry equivalent to that component.

COMMISSIONER POWELL: That's right. So, yeah ... thank you, sir. That's all.

MR. SAUNDERS, PRESIDING CHAIRMAN: Thank you, Commissioner Powell. Mr. Pelly, just a couple of points of clarification. The unemployment variable, first of all, is that used in other jurisdictions besides Newfoundland in calculating your rates?

MR. PELLY: We use it specifically in conjunction with trend and as our sort of default approach, again adopting that terminology. We test the statistical significance of the unemployment variable for every coverage in every jurisdiction for which we do pricing work. It is adopted in ... this year I think there are several instances. The frequency with which it gets adopted in this application is typical of what we find in other jurisdictions.

MR. SAUNDERS, PRESIDING CHAIRMAN: I think you said somewhere in your evidence in answer to a question that it doesn't have that much of an impact or it's not significant, something to that effect. I was trying to find it and I couldn't find it before we came in this morning, but I recall someone asking you what the impact was of the unemployment variable.

MR. PELLY: Well, I ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Do you recall that?

MR. PELLY: I'd be surprised if I said it wasn't significant, because, number one, we wouldn't include it if it wasn't a statistically significant variable to the regression itself, and in terms of its impact on the forecasted frequency, which is typically where it arises, looking at the regressions in this application where there is a regression variable or there is an unemployment regression variable, a one percentage point movement in the unemployment rate can make a fairly significant shift in the forecasted frequency, so I wouldn't want to say that it was insignificant.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. I must have misunderstood. Staying with page ten that we were talking about a moment ago when Mr. Powell was asking you questions, I just want to get a clearer understanding of what that chart means there, and maybe ... now, if I ask you any questions that you believe Mr. Simpson would be best able to answer, then by all means let me know that.

MR. PELLY: Okay.

MR. SAUNDERS, PRESIDING CHAIRMAN: But according to the Automobile Insurance Act, I think it is, Facility is not allowed to make a profit. Facility is deemed to be a non-profit organization.

MR. PELLY: The entity that is Facility Association is a non-profit entity, and so therefore it's a mechanism whereby it provides a service, if you want to think of it that way, or it facilitates a process.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes, I'm familiar with that and we have ruled on that and we agree with that. My question is in the whole process, if you like, brokers do get paid for selling Facility business, I'll call it Facility business, for selling insurance to insureds who end up in Facility. Brokers get a commission.

MR. PELLY: That's correct.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. Now, what do the servicing carriers or member carriers get from that premium? Is there a commission?

MR. PELLY: Member companies do not get any allowances.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MR. PELLY: Unless they're a servicing carrier. I mean, there's an overlap between servicing carriers and member companies, so only servicing carriers of the subset of servicing carriers who are entitled to allowances under the Facility Association ...

MR. SAUNDERS, PRESIDING CHAIRMAN: What do you mean by allowances? What ...

MR. PELLY: There are allowances under three or four headings. I would need the plan of operation in front of me in order to account for them specifically but in

general terms there's a servicing carrier claims adjustment expense allowance, there's a servicing carrier operating expense allowance and there's a servicing carrier fee. Those are the three that I can recall right now. Mr. Simpson probably would be better positioned to be able to respond but if there's a plan of operation of Facility Association in this evidence around me here, I'd be happy to look quickly and refresh my memory on that.

MR. SAUNDERS, PRESIDING CHAIRMAN: Do we have that handy?

MR. PELLY: I don't know that it was filed with this. I'm sure Mr. Simpson could speak to that.

MR. SAUNDERS, PRESIDING CHAIRMAN: Well, we can defer it to Mr. Simpson if you think he's the proper witness to answer it.

MR. PELLY: Well, I mean, I have familiarity with it too. I'm not trying to dodge the question.

MR. SAUNDERS, PRESIDING CHAIRMAN: No, I'm sure you're not.

MR. PELLY: I just didn't refresh my memory on the details. Thank you. I believe the three that I just cited are indeed the three that are applicable.

MR. SAUNDERS, PRESIDING CHAIRMAN: So they were claims adjustment expense, servicing carrier fee ...

MR. PELLY: I'll give you the proper names of them now.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MR. PELLY: So that I don't paraphrase. There's an operating cost allowances, excluding claims expenses, and in this jurisdiction that is nine percent of written premium. There is a service fee, which is in this jurisdiction is one percent of written premium, and there's an allowance for claims expenses, both allocated and unallocated, which in this jurisdiction is ten percent of earned premium, subject to a retroactive adjustment which depends upon the loss ratio, and I think that's an accident year loss ratio. So it can range up and down from that, the claims expense provision can range up and down from that ten percent subject to limits depending upon the outcome of the accident year. Now, of those three components, and your question was focusing on the table on page ten of the application ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MR. PELLY: ... the servicing carrier fee is, appears as a standalone item of one percent and it's labelled as servicing carrier fee. You can see that as the third item down in the table.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MR. PELLY: The operating cost provision is a component of the last item in the table, which is labelled operating expenses. The claims service fee is not included in this table but rather is dealt with on an actual cost basis instead of the contractual basis underlying the servicing carrier agreement as a component of claims.

MR. SAUNDERS, PRESIDING CHAIRMAN: And the commissions that you show there are broker commissions?

MR. PELLY: That's correct. Now, there is a lower commission rate paid on private passenger business in Classes 10, 11 and 12. I think it's nine percent. I stand to be corrected but I believe it's nine percent. Actually I can verify that. And we make an adjustment to recognize the lower commission on those three classes in the derivation of the class differentials for private passenger Classes 10, 11 and 12. Yes, it's nine percent.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. There is of course the investment income that arises from the premiums collected on Facility business.

MR. PELLY: That's correct. That's recognized in the rate-making model basically through a discounted cash flow calculation. It's described, it still is further on in Section 2.7 of the narrative.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. And finally I wanted to ask you about the taxi operators, just a follow-up question to one that Mr. Powell asked you. You made the comment that there was a higher percentage of taxi operators insured through Facility in some jurisdictions.

MR. PELLY: Than is the case for, typically for private passenger vehicles.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes. And that's because of the mix, I assume, or am I making the wrong assumption? Is that ... are all taxi operators insured through Facility, first of all? Let's take Newfoundland?

MR. PELLY: No. A portion of the market is insured by the voluntary market.

MR. SAUNDERS, PRESIDING CHAIRMAN: Right, and a portion would be insured through the so-called grey market insurers.

MR. PELLY: I don't know.

MR. SAUNDERS, PRESIDING CHAIRMAN: I'm assuming that.

MR. PELLY: I don't know who the carriers are in the voluntary market. I would encompass non-standard and standard market companies together in that regard.

MR. SAUNDERS, PRESIDING CHAIRMAN: Similarly in other jurisdictions you'd have the same situation exist.

MR. PELLY: As a general observation.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MR. PELLY: Now, this current application affects the rates for taxis indirectly through the flow-through effect of those coverages for which taxi rates are dependent upon private passenger or commercial rates. My recollection, and I can verify this, I think, my recollection is that it's only the physical damage coverages for taxis that are dependent upon private passenger or commercial, but give me one moment and I'll verify that.

(10:15 a.m)

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MR. PELLY: That's correct, it's only the physical damages coverages for taxis that are going to be affected by the proposed changes for private passenger vehicles specifically.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. Those are all the questions I have of Mr. Pelly. Thank you, Mr. Pelly. Questions arising? We should begin with the Consumer Advocate, fair enough?

MS. NEWMAN: I would think that it would be appropriate for all the same ... I mean, you'll have a last kick at the can, we can start with the Consumer Advocate and come back to you or we can start with you, do you, me, and then come back to the ...

MR. STAMP, Q.C.: (unintelligible) last, Mr. Chairman. I'm prepared to wait ...

MS. NEWMAN: They would have ...

MR. STAMP, Q.C.: ... until everybody finishes and then we'll ...

MS. NEWMAN: ... ordinarily an opportunity to reply.

MR. O'FLAHERTY: I'm prepared to go ahead, Mr. Chairman, at this stage.

MR. SAUNDERS, PRESIDING CHAIRMAN: You are?

MR. O'FLAHERTY: I'll just follow up on the issue of the taxi operators. I had understood your evidence to be that there was a higher percentage of taxi operators insured through the Facility mechanism than through the voluntary market as a percentage basis, similar to the analysis that we requested regarding senior citizens. Did I misunderstand that?

MR. PELLY: I mustn't be explaining or expressing myself very clearly this morning. If one calculates a market share as being the number of vehicles, a Facility Association market share as being the number of vehicles in Facility Association divided by the number of vehicles insured for the industry as a whole, what I'm trying to say is that the Facility Association market share for taxis is typically a higher percentage than the Facility Association market share for private passenger vehicles. So, for example, for private passenger vehicles, if it's in the vicinity of five percent, for taxis it might be 25. I'd have to actually find out what the number was to tell you what it was.

MR. O'FLAHERTY: And perhaps the problem was with my question. That's the point that I was trying to get at. That was what I understood from your answer. And then my second question on that is, do you have a sense of what that percentage is in Newfoundland and Labrador?

MR. PELLY: My memory isn't good enough to be able to quote that number off the top of my head. It's a readily available statistic.

MR. O'FLAHERTY: Do you think you could provide that?

MR. PELLY: That can be provided.

MR. O'FLAHERTY: Thank you. A last question on the taxi operators. Would taxi operators also be affected by the proposed changes to the accident and conviction surcharges and clean driver discount package?

MR. PELLY: Yes, with respect to the changes proposed for the accident and conviction surcharge schedule. No, with respect to the clean driver discount, which is only proposed for private passenger vehicles.

MR. O'FLAHERTY: So they would ... but they would be potentially affected by the proposed changes to the accident and conviction surcharges.

MR. PELLY: Yes, and the proposed approach, as I think I said in my direct evidence, the proposed approach for implementation of this would be, the effect of it would be to reduce the base rates for the manual rates that appear in the rate manual in the anticipation that there will be, the reduction will be offset by the increased premium income arising from the surcharges, so the base rates for drivers without accidents and convictions would go down.

MR. O'FLAHERTY: Or, in this case, because it's in conjunction with an increased ...

MR. PELLY: To those who have accidents and convictions.

MR. O'FLAHERTY: Alright, okay. I just have a couple of other questions. Regarding the issue of the allowances to the servicing carriers, you mentioned that the ten percent of earned premium, which is provided as the claims cost allowance, is subject to a retroactive adjustment that depends on the loss ratio.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Can you just explain to me how that might work in practical terms?

MR. PELLY: Well, the concept is that if the loss ratio is a larger than expected or lower than expected percentage of earned premium, then so too might the loss adjustment expenses. That's the premise for making the adjustment. Now, you're asking how it works in practice.

MR. O'FLAHERTY: And if this is a question that might best be directed to a servicing carrier, then please feel free to defer that.

MR. PELLY: Well, I can tell you how it works as soon as I find it again. Funny, I flipped right to it last time. I'll just read from the Facility Association Plan of Operation, Article IX, which is headed "Servicing Carrier Appointments and Allowances," paragraph 2(b), as in "Brian," and it's the second last paragraph under that heading. "The rates will be adjusted retroactively in accordance with the formula described in the Accounting and Statistical Manual, Chapter 8, which on average increases (decreases) the rate by 0.5 percent for each five percent of increase (decrease) in that loss ratio." There are ... if one were to refer to the Accounting and Statistical Manual, which I'm guessing probably isn't on file right now for this hearing, there are limitations on how much of an adjustment can happen, but in effect for every five points that the loss ratio moves up or down from the initial target assumption, there's a 0.5 percent percentage point adjustment to the claims expense, claims service fee provision.

MR. O'FLAHERTY: Okay. So just in terms of to sum it up then in practical terms, are you indicating that if there's a favourable loss ratio for the claims for Facility that the expenses will go down?

MR. PELLY: The allowance paid to servicing carriers would be a lower percentage of premium.

MR. O'FLAHERTY: Thank you. And the last area I wanted to ask you about was Mr. Powell had asked you about, for a layman's explanation of the issue of the more aggressive claims environment and you then, your evidence went into a distinct description or, I suppose, distinction between adverse development and favourable development, and I just wanted to follow up on the issue of the adverse claims environment. Did I understand you to say that that related to issues that dealt with increased claims for soft tissue injuries and higher damage awards, I guess from the courts, and an increase in claimants retaining legal counsel? Were

those the issues that you were relating to the more aggressive claims environment?

MR. PELLY: That's my recollection from the IBC closed claims study. I did not ... I haven't read that in about six months so my memory is a little bit fuzzy on that but that's my recollection.

MR. O'FLAHERTY: And does that IBC closed claims study, does that relate to this Newfoundland and Labrador market?

MR. PELLY: The ones that I've looked at, that I recall looking at, were for Nova Scotia and New Brunswick. I'm not sure if one was done for Newfoundland and Labrador, to be honest. I don't know, and I know I haven't read that one, but I can tell you that the observations that I've made generally about a harsher claims environment, there are similar patterns evident in Newfoundland and Labrador to what I've seen in Nova Scotia and New Brunswick, so I'm making a bit of a leap that I'm attributing observations or conclusions reached by the Insurance Bureau of Canada to Newfoundland and Labrador, and absent reading a similar closed claims study, I'd have to live with making that leap.

MR. O'FLAHERTY: No problem. I just wanted to establish then ... so you haven't reviewed a particular study regarding Newfoundland and Labrador at this time. You're making the same assumption that those sorts of considerations would apply to our particular claims environment.

MR. PELLY: That's true.

MR. O'FLAHERTY: I think I'll follow up with Mr. Simpson if I have any other questions in that area. Thank you very much, sir. Thank you, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: Thank you, Mr. O'Flaherty. Ms. Newman?

(10:30 a.m.)

MS. NEWMAN: Yes, I just have a couple of questions. I wanted to clarify about the commissions you pay to the brokers. As the rates go up, is it true that the commissions paid to the brokers go up because they're based on the percentage of the rates?

MR. PELLY: The dollar amount of commission would go, be higher on a higher premium, given that it's a percentage of premium.

MS. NEWMAN: Okay. And so that means that if an insured's premium goes up 80 percent, as we saw yesterday, then the commission paid to the broker would go up 80 percent? Is it as direct as that?

MR. PELLY: Assuming that such a policyholder existed, that would be the case.

MS. NEWMAN: Okay. And in some other jurisdictions there is a limit on this commission paid to brokers, a dollar limit, while it might be based on a percentage, is that true?

MR. PELLY: That's true in Ontario for certain classes of vehicles.

MS. NEWMAN: But there's no limit in Newfoundland?

MR. PELLY: That's correct.

MS. NEWMAN: Okay. Those are all my questions.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. Mr. Stamp, are you ready to ...

MR. STAMP, Q.C.: Yes, I am, Mr. Chairman. Mr. Pelly, just coming back for a moment to the issue that's been raised now by a couple of people, I guess, and I think Commissioner Powell brought it up initially, I guess the definition or explanation of the concept of adverse development or favourable development or, as you referred to it, favourable run-off or, I guess, adverse run-off, it's the same thing, is it not, we're talking about?

MR. PELLY: As expressions they mean the same thing.

MR. STAMP, Q.C.: Now, I'm just interested in, from this one narrow perspective. I think you've said already that it is your observation, based on the experience and data that you've seen that Newfoundland in general and I guess Facility Association in particular is experiencing a harsher claims environment.

MR. O'FLAHERTY: Mr. Chairman, I don't recall Mr. Pelly actually giving that evidence based on data. I think we just spoke about that a moment ago and he was making that observation based on his impression

of the closed claim study from the IBC, so I'd just put that on the record.

MR. STAMP, Q.C.: That's not what I understood at all, Mr. Chairman. I understood that, Mr. Pelly can answer this question in a moment, I understood that he was asked to explain the reasons for the harsher environment and attribute it to what he had seen in the other jurisdictions and said that likely would be the same reasons in this jurisdictions. He can tell us himself whether there is a harsher environment, whatever the reasons might be. Mr. Pelly, can you just ... I'll ask you that first of all then.

MR. PELLY: I would agree with Mr. Stamp's interpretation of my evidence over Mr. O'Flaherty's. There is evidence in the application of the harsher claims environment in both industry and Facility Association. It's harder to see in Facility Association data because there's more variability inherent to the smaller body of experience, but it's clearly evident in the industry experience.

MR. STAMP, Q.C.: Alright. So what you're saying is that there is a harsher environment evident from the data in the industry experience.

MR. PELLY: That's correct.

MR. STAMP, Q.C.: And just to come back to the Consumer Advocate's observation, he asked could you, I think, identify the reasons for that, and you cited a closed claims study or studies, one in New Brunswick, one in Nova Scotia apparently, or maybe the same ones, I don't know, but in any event closed claims studies which appear to indicate that increased litigation, soft tissue injury claims and awards were a feature in the explanation in those other jurisdictions as to the reasons for the harsher claims environment.

MR. PELLY: That's my evidence.

MR. STAMP, Q.C.: Okay. And you have extrapolated that information to in part explain why you observe a harsher claims environment in this jurisdiction.

MR. PELLY: That's accurate.

MR. STAMP, Q.C.: To get back to the point I started to ask you about, which, don't want to lose that, when you have a harsher claims environment, that would, I would expect that that would indicate that a claim that occurs tomorrow will be, you know, pursued in a more aggressive fashion perhaps than a claim that was, that occurred and was resolved ten years ago.

MR. PELLY: If that earlier claim is completely history and ...

MR. STAMP, Q.C.: Yes.

MR. PELLY: ... has been closed and we're in a more harsher claims environment today, then the expectation is there's more propensity to pursue the claim aggressively today than existed on that earlier claim.

MR. STAMP, Q.C.: What about the very thing you've brought up, what about the fact that a claim that's now, say, five or whatever years old, has not been fully resolved?

MR. PELLY: Any pending claim, and even to a limited extent some claims that are closed, but any pending claim still has the potential to respond to an increasingly litigious environment. It depends upon the details of the individual claim, of course, and whatever legal counsel was open to that person, but ...

MR. STAMP, Q.C.: Do you recall the chart on page 12 of Mercer's Report, Mercer's reply to filing?

MR. PELLY: I have that.

MR. STAMP, Q.C.: And do you recall the fact that Mercer's prepared, their actuarial professionals prepared two additional charts?

MR. PELLY: In addition to amending ...

MR. STAMP, Q.C.: Yeah. I don't know if you need the charts exactly but there were actually three charts prepared one amended the one that's in page 12, I think, I think there's some sort of minor error, and then ...

MR. PELLY: That was in response to question FA 1.0.

MR. STAMP, Q.C.: Okay. And then there was two new charts. And what did that chart on page 12 and the two new charts in the answer indicate to you with respect to loss development?

MR. PELLY: Well, the original chart, which compared the estimates of ultimate incurred losses for five accident years from 1992 to 1996 compared those

estimates as they appeared in a December 1997 rate filing with the estimates in the current application, and the general observation that I drew from this was that the estimates in the earlier filing were high by a considerable margin. That is a reflection of the favourable run-off that the industry experienced over calendar years in the period, well, right around the time and shortly following the December 1997 filing, and that favourable run-off was a topic of some discussion of the previous rate hearing, sorry, not rate hearing but the previous Facility Association hearing here. The Board's expert on that occasion analyzed that situation quite extensively and came to the conclusion that the estimates underlying previous applications, technically not including the December 1997 application, but applications in that time frame, were reasonable estimates given the information available at the time and that the favourable run-off was not reasonably foreseeable. The two additional tables prepared in response to FA 1.0 present a comparison of the previous applications, the May 2001 application, estimated ultimate incurred losses for 1995 to 1999 accident years compared with the corresponding estimates in the current application. There are actually two tables here because for this particular coverage, and this is bodily injury for private passenger vehicles, there was an initial analysis done and then there was an updated analysis done using slightly more mature data in the application, and both were included, so for completeness Mercer's included the comparison for both of those estimates, but as a general observation, I guess, with respect to either of the tables, of the five accident years shown here, four of the five accident years show unfavourable or adverse development but of a much lesser, much reduced significance compared to the favourable run-off that we observed earlier on those accident years with one of them showing some minor favourable run-off. So I think these are more like estimation noise, the differences between the previous application and this application, whereas the December 1997 application is, I think, a demonstration of the, now what is known to be conservativeness of the estimates in that December 1997 application given the favourable run-off that occurred since.

MR. STAMP, Q.C.: So you're not seeing the favourable run-off continue?

MR. PELLY: To the contrary, what we're observing is there is adverse run-off, the beginning of a wave of a harsher claims environment.

MR. STAMP, Q.C.: Mr. Pelly, just one other point I want to ask you about. The Chairman has raised the issue of the, I guess, chart at page ten and the issue, I guess, service carrier allowances in particular. Now, you've described three features of allowances or fees, whatever, paid for service carriers, or to service carriers. I want to just make sure I understand what those, what the purpose of those fees or commissions or whatever they are that service carriers receive. Why are they paid anything at all?

MR. PELLY: They are functioning on behalf of Facility Association to facilitate the provision of coverage and the settlement of claims as they arise to policyholders that are insured through Facility Association, so just like a normal insurance company incurs costs to function, to operate, so too does that servicing carrier incur costs in order to function on behalf of Facility Association as the insurer, so it's a recognition of that cost of operation and the formula does get revisited periodically and make sure that the servicing carriers are being adequately compensated for their efforts.

MR. STAMP, Q.C.: So this is really a reimbursement to those service carriers of the expenses they incur as service carriers.

MR. PELLY: Well, reimbursement implies that there may be a dollar for dollar relationship and it's not that precise. It's intended to be an allowance to provide them with funds to facilitate them providing those services.

MR. STAMP, Q.C.: Now, is there any fee or commission paid to member companies who are not service carriers?

MR. PELLY: No.

MR. STAMP, Q.C.: So we know we've heard some discussion and through the course of this hearing so far that there have, that there are, I don't know, something in the order of 50 or in excess of 50 automobile insurers licensed to write insurance, automobile insurance, in this province, and I think we have evidence that, indications have been given that there are four service carriers, is that correct?

MR. PELLY: I can confirm the four servicing carriers, yes.

MR. STAMP, Q.C.: And I think the Superintendent's pre-filed evidence suggests there are more than 50 auto insurance licensed ... so 4 of the 50 or so are paid for their work as service carriers and the other 46 or so do not receive any payment as a service carrier.

MR. PELLY: That's correct.

MR. STAMP, Q.C.: And so then by way of sort of general observation, brokers who sell the product get paid a fee.

MR. PELLY: Commission, yes.

MR. STAMP, Q.C.: Commission. And the service carriers who carry out the work on behalf of Facility Association, there's an attempt made to reimburse them for their expenses.

MR. PELLY: They're paid allowances, yes.

MR. STAMP, Q.C.: Paid for their work. And no fee or no commission is paid to the member companies whose capital is at risk.

MR. PELLY: That's correct.

MR. STAMP, Q.C.: That's all I have, Mr. Pelly, thank you. Thank you, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. Thank you, Mr. Stamp. So are we ready to ...

MS. NEWMAN: Mr. Chairman, I believe that Ms. Elliott is prepared to proceed, however, she does have to set up her computer, so it might be an opportune time to take a break and ...

MR. SAUNDERS, PRESIDING CHAIRMAN: This may be an ideal time to have a break, yeah.

MS. NEWMAN: And allow her to get set up so that we can come back and proceed right away.

MR. SAUNDERS, PRESIDING CHAIRMAN: I'd like to thank you, Mr. Pelly. It's been a long session.

MR. PELLY: It's with great reluctance I relinquish this chair.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. We'll break until 11 o'clock.

MR. STAMP, Q.C.: Mr. Chairman, just one further ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes, I'm sorry.

MR. STAMP, Q.C.: ... small point, if I may. Mr. Pelly was asked to provide some additional ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Certain information.

MR. STAMP, Q.C.: ... information yesterday.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MR. STAMP, Q.C.: He's still attempting to obtain that. We hopefully will have that fairly soon and as soon as it's available we'll make it available to everybody else.

MR. SAUNDERS, PRESIDING CHAIRMAN: That'll be fine.

(10:45 a.m.)

MR. WHALEN, Q.C.: I presume, Mr. Chairman, that everybody has gotten the answers to those questions ...

MR. GOODLAND: We've received the answers.

MR. WHALEN, Q.C.: Okay. Now, I think they're slightly out in terms of the beginning year, but other than that they're ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MR. PELLY: With respect to that exhibit from the filing, I can confirm that my testimony was accurate that it's just an ordering problem in the right-hand column and that the calculation is unaffected by the ordering, the presentation error. I'm just trying to get the exhibits provided to me so that I can get them printed.

MR. SAUNDERS, PRESIDING CHAIRMAN: Very well. Okay, 11 o'clock.

(break)

(11:15 a.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: Ms. Elliott, do you want to take the Bible in your right hand,

please? Do you swear that the evidence you're about to give will be the truth, the whole truth, and nothing but the truth, so help you God?

MS. ELLIOTT: I do.

MR. SAUNDERS, PRESIDING CHAIRMAN: Thank you. Ms. Newman?

MS. NEWMAN: Perhaps before we start if we could clarify just for logistics when we might be taking our next break. I would suggest sometime around 12:15, sometime around 12:15, 12:30, that sort of thing.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yeah.

MS. NEWMAN: That would be about an hour now and an hour after. Okay. Ms. Elliott, do you have a glass of water?

MS. ELLIOTT: I do.

MS. NEWMAN: Okay, good morning, and thank you for braving our wonderful weather.

MS. ELLIOTT: Yes, everyone did.

MS. NEWMAN: Hopefully this will all be over and you'll be able to easily exit our fair province at the end of the week. I have circulated a copy of your CV that I think all the parties should have and the Board should have a copy of that as well. I think we'll mark this as an exhibit as it wasn't attached to the report. It will be PLE-1. For purposes of identifying your expertise and having you declared as an expert witness, Ms. Elliott, can you please describe your training and qualifications?

EXHIBIT PLE-1 ENTERED

MS. ELLIOTT: I'm a Fellow of the Casualty Actuaries Society, I'm a Fellow of the Canadian Institute of Actuaries. I have a Bachelor of Mathematics from the University of Waterloo. I'm employed by Mercer Risk, Finance, and Insurance Consulting Limited. I've been a consulting actuary, I'm a principal there. I've been a consulting actuary there for almost five years.

MS. NEWMAN: Okay, and can you speak up a little bit too, please, perhaps ... I don't know if you can get the microphone a little closer there.

MS. ELLIOTT: Yes, I will.

MS. NEWMAN: Okay, there you go.

MS. ELLIOTT: Okay, let me know if you can't hear me.

MS. NEWMAN: Alright, and have you ever given previous testimony in this jurisdiction?

MS. ELLIOTT: No, I have not.

MS. NEWMAN: How about in other jurisdictions?

MS. ELLIOTT: Yes, in the Province of Nova Scotia. We were retained by the Public Utility Board in Nova Scotia to review the automobile insurance rate situation in that province.

MS. NEWMAN: Okay, so you have been engaged by similar boards in other jurisdictions to do this sort of review work?

MS. ELLIOTT: Yes, we review automobile rates in the Province of Ontario, we've been retained, as we said, for the Province of Nova Scotia, and we also provide services to the Province of Alberta. My specialty is automobile insurance for regulators.

MS. NEWMAN: Okay, and having reviewed the matter and sat through the testimony to date, I wonder if you could please express your expertise which may be relevant to this matter?

MS. ELLIOTT: Well, on behalf of the Financial Services Commission of Ontario, we get to review numerous rate filings on behalf of the regulators, and we're very familiar with how rate filings are prepared, the various pieces that comprise the rate filings, so we review hundreds of rate filings so we're extremely familiar with the process.

MS. NEWMAN: Okay, Mr. Chairman, those are all my questions for this particular witness, I don't know ... on the issue of the qualification. I don't know if my learned friends have any questions they'd like to ask on that topic.

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

MR. STAMP, Q.C.: Mr. Chairman, I have a couple of questions, but I think our position would be that we

would go last, both in this area and in the area of cross-examination generally.

MR. SAUNDERS, PRESIDING CHAIRMAN: Your comment on that, Mr. O'Flaherty?

MR. O'FLAHERTY: I don't agree with that. I believe it would be Mr. Stamp would be next in order, and that we would be the last party to cross-examine Ms. Elliott, and in terms of the questions for her, I can just advise you, we don't have any questions about her qualifications. We're prepared to accept her as an expert. If there is a procedural issue, maybe we should deal with that now.

MR. SAUNDERS, PRESIDING CHAIRMAN: Well, let me explain this, first of all, that we discussed this prior to coming in because I understood that there was some disagreement between you both in terms of who should go first. I think Mr. Stamp should go first. However ...

MR. STAMP, Q.C.: Mr. Chairman, if I may ...

MR. SAUNDERS, PRESIDING CHAIRMAN: However, this is an information seeking body that endeavours to get as much information and evidence on the record as we can and even though we try to stick to a procedure that is similar to what may be, to what may be encountered in the courts, we don't always, and I don't recall ever there being a situation where we disallowed a party from asking questions for clarification purposes on on follow-up, and so no matter which of you goes first, if there's anything arising out of the other's questions, then certainly we would be hard pressed not to allow you to ask a question.

MR. STAMP, Q.C.: On that basis, Mr. Chairman, I'm happy to go second.

MR. SAUNDERS, PRESIDING CHAIRMAN: Happy to go second.

MR. STAMP, Q.C.: Behind Ms. Newman.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes, which means that Mr. O'Flaherty will be last.

MR. O'FLAHERTY: That's fine, thank you.

MR. SAUNDERS, PRESIDING CHAIRMAN: Of the first round.

MR. STAMP, Q.C.: Of the first round, and then anything that arises from the Consumer Advocate's questioning of Ms. Elliott, that I haven't dealt with, or haven't dealt with adequately, we'll have an opportunity, obviously, to revisit those with her ourselves.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, fair enough.

MR. O'FLAHERTY: That's fair, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, that being dealt with now, what's next? Oh yes, you were going to have a question on the qualifications.

MR. STAMP, Q.C.: Just a few questions.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, carry on.

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

MS. ELLIOTT: Good morning.

MR. STAMP, Q.C.: Your CV indicates that you are a principal and a consulting actuary with Mercer's. Just first of all, what is a principal?

MS. ELLIOTT: Well, it would be close to the equivalent of partner but it is not a partner. It's just a recognition of the contribution of individuals to the practice, it's a titling.

MR. STAMP, Q.C.: Okay, so does Mercer's have partners in Canada?

MS. ELLIOTT: We do not.

MR. STAMP, Q.C.: Okay, and you indicate that you have 20 years of actuarial financial reporting and insurance company management experience, and I just want to, I have some questions in the course of the cross-examination generally on these topics, but just on this preliminary stage, can you tell us then where you have obtained the experience?

MS. ELLIOTT: Yes, I'll go back in time. I originally was employed with a consulting firm when I first started my career. I worked at Dominion of Canada, and from that consulting firm I moved on to Dominion of Canada ...

MR. STAMP, Q.C.: How long were you with the consulting firm?

MS. ELLIOTT: About two and a half years.

MR. STAMP, Q.C.: And when did you start there?

MS. ELLIOTT: In 1978.

MR. STAMP, Q.C.: Alright, and you were two and a half years with that firm?

MS. ELLIOTT: Approximately.

MR. STAMP, Q.C.: Alright, and you moved to the Dominion of Canada, you say?

MS. ELLIOTT: I moved to Dominion of Canada. I worked there as an actuarial student. I worked there for maybe about ten years, and from there I moved to a company at the time that was called Halifax Insurance Company, now known as ING, and I was there for close to 15 years.

MR. STAMP, Q.C.: And what was your position at Halifax Insurance when you started work there?

MS. ELLIOTT: I think I was the manager of the actuarial department when I started.

MR. STAMP, Q.C.: And what would that involve, being the manager?

MS. ELLIOTT: Well, I was the manager when I started, but over the course of the 15 years I rose through the company. I was vice-president of the firm. I had roles in both underwriting and actuarial in the firm, so I was in charge of pricing, we were in charge of reviewing loss reserves, the departments were very small back then so we had a small staff and we really had to cover a lot of bases.

MR. STAMP, Q.C.: And on that point, how many actuaries were employed with Halifax Insurance during the period you were there?

MS. ELLIOTT: It would be tough for me to say how many during the period that I was there, we are talking 15 years. At the time that I left there there probably was a staff of maybe seven, five or seven in Toronto.

MR. STAMP, Q.C.: All actuaries?

MS. ELLIOTT: No, I think there'd probably be two, two admin people, but I really am guessing at that, I can't recall each individual person at this point.

MR. STAMP, Q.C.: And so when you left Halifax Insurance Company, when was that by the way?

MS. ELLIOTT: I think that was 1997/98, in there.

MR. STAMP, Q.C.: You're not sure.

MS. ELLIOTT: I don't have that etched in stone, I'm sorry.

MR. STAMP, Q.C.: Were you the senior actuary with Halifax Insurance when you left?

MS. ELLIOTT: Our company, the company, ING Halifax, underwent many, many changes when I was there. At one point in my career I was the senior actuary within the Halifax company. We merged with various companies, so the actual head office moved out of the Toronto environment to (inaudible) in Quebec, so all the senior executives, all the senior VPs that then at the time I left in Quebec.

MR. STAMP, Q.C.: And were you in Quebec?

MS. ELLIOTT: No, I was in Toronto.

MR. STAMP, Q.C.: So do I take it from that you were not one of the senior VPs at that time?

MS. ELLIOTT: I was the Vice-President of Actuarial.

MR. STAMP, Q.C.: But who was senior actuary?

MS. ELLIOTT: His name would be Claude Desoliel *(phonetic)*.

MR. STAMP, Q.C.: Okay, and in your CV you've also described bringing the property and casualty actuary expertise to Mercer's. Now, I presume with Halifax Insurance that was your, the nature of your work was property and casualty.

MS. ELLIOTT: That's correct.

MR. STAMP, Q.C.: Actuarial work?

MS. ELLIOTT: Correct.

MR. STAMP, Q.C.: Okay, and that included auto, I presume.

MS. ELLIOTT: Correct.

MR. STAMP, Q.C.: Did it include other areas of insurance as well as auto?

MS. ELLIOTT: Yes, Halifax was mainly a personal lines insurer so we covered automobile and homeowners, yes.

MR. STAMP, Q.C.: Can you give a breakdown, Ms. Elliott, to the degree of work involving auto insurance or actuarial work involving auto insurance as opposed to the other lines that you were involved in?

MS. ELLIOTT: I would say, and again, I apologize, if you would like a guess from me, I would say at least half my time was on automobile, but I'm afraid that would be difficult for me to give you an exact answer.

MR. STAMP, Q.C.: Alright, and you left Halifax Insurance in 1977 or 19 ... I'm sorry, 1997 or '98?

MS. ELLIOTT: Yes.

MR. STAMP, Q.C.: And when did you join Mercer's?

MS. ELLIOTT: I took some time off and I joined Mercer's, it will be, this ... April 1st this year it will be five years that I will have been at Mercer's.

MR. STAMP, Q.C.: April 1st, 2003?

MS. ELLIOTT: Yes.

MR. STAMP, Q.C.: Okay, next year. Alright, and how many property and casualty actuaries does Mercer employ in Canada?

MS. ELLIOTT: Myself, one.

MR. STAMP, Q.C.: Just one. Mr. Chairman, that's all the questions I have on the issue of Ms. Elliott's expertise. I have some general questions in cross-examination on this topic in any event, but for this purpose, that's fine, thank you.

MS. ELLIOTT: You're welcome.

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

MS. NEWMAN: I guess I would ask the Board to declare Ms. Elliott an expert in actuarial science with a specialty in property and casualty insurance.

MR. SAUNDERS, PRESIDING CHAIRMAN: So declared.

(11:30 a.m.)

MS. NEWMAN: Thank you. Ms. Elliott, I wonder if you could please briefly walk us through the general approach that you ... perhaps we'll step back, sorry, did you participate in the preparation of the Mercer report as it's been called so far in this proceeding, I think the proper title is Facility Association Rate Filing Review, Newfoundland and Labrador Board of Commissioners of Public Utilities, dated November 26th, 2002?

MS. ELLIOTT: Yes, I did participate in it, yes.

MS. NEWMAN: Okay, and what was the extent of your involvement in this report?

MS. ELLIOTT: I prepared the report, the calculations, in conjunction, we would have a peer reviewer, Mr. Ted Zubulake, who is in the room, would have been the peer reviewer, but I'm the author of the report.

MS. NEWMAN: Okay, and can you please describe what you mean by peer reviewer briefly?

MS. ELLIOTT: In our firm we undergo a process where reports and calculations are typically reviewed by another colleague at a senior level, and that we believe helps provide a high quality report.

MS. NEWMAN: Okay, and this is a normal process in your firm?

MS. ELLIOTT: That process is applied to all reports that we prepare for clients, yes.

MS. NEWMAN: Okay, so are the findings in the report your own findings without the influence of others, with the exception of the assistance that you might have received from people within Mercer's?

MS. ELLIOTT: That would be correct.

MS. NEWMAN: Okay, and so can you testify as to all of the contents of this report?

MS. ELLIOTT: Yes, I can.

MS. NEWMAN: Okay, and do you adopt the report in its entirety?

MS. ELLIOTT: I do adopt the report in its entirety but I would like to make two clarifications in response to questions that we received from the FA. We found that, and it's been provided in response number one to the FA, there was a minor typo, that correction was provided. And then the response to question number five, we found that a risk adjustment factor hadn't been linked within our Excel sheet, and that actually reduced the finding of the commercial automobile rate level indications by a full point, so they're the additions that I would like to make.

MS. NEWMAN: Okay, I have circulated to the parties, I don't know if they still have copies of them, two statements of principles, the first statement of principles ... do the parties have copies of these two statements, okay, so we'll circulate copies. The first of these statements that we'll address is the statement of principles regarding property and casualty insurance rate making, it's the thinner of the two, and ... yeah, and this would be PLE-2.

EXHIBIT PLE-2 ENTERED

And the second one is the statement of principles regarding property and casualty loss and loss adjustment expense reserves which we will label PLE-3.

EXHIBIT PLE-2 ENTERED

Are you familiar with these two statements of principles?

MS. ELLIOTT: Yes, I am.

MS. NEWMAN: And can you please describe what they are or what they represent?

MS. ELLIOTT: Ms. Newman, I'm afraid that I don't have the copy with me. I apologize.

MS. NEWMAN: Okay, well perhaps we'll provide a copy now. Sorry for that.

MS. ELLIOTT: Thank you. In both cases these are guidelines prepared by the Casualty Actuarial Society, which I'm a Fellow of the Casualty Actuarial Society, and they provide guidance to the actuary in preparing rate making, going through the rate making exercise and in terms of the loss and loss adjustment expense reserves, again, guidance to follow when going through the exercise. These are principles that one would review and follow the guidelines, understand the terminology when one's performing the various exercises related to them.

MS. NEWMAN: Okay, thank you. Now, we'll move on to your general approach, can you please briefly just walk us through the general approach that you followed in reviewing the FA rate application?

MS. ELLIOTT: Okay, let me begin by saying that we've reviewed rate filings of the FA in other jurisdictions and so we're familiar with the general methodology applied by the FA in developing its rate level indication. In general we have found the FA filings to be well presented and for us as actuaries, they're relatively easy to follow. I know that may not be the case for everybody in the room, but they are well presented.

Our general approach in reviewing this application was not to conduct a full independent analysis of the FA's rate level need. Rather, our approach was to accept FA's methodologies and judgements where we found them to be generally reasonable and to use other methodologies or judgements in those instances where we found alternatives to be more appropriate.

For example, we accepted the rates that FA applied to each of the years 1997 through to 2001, as we found the rates to be reasonable, even though they may not be the rates we would have selected had we performed an independent review of FA's rate level needs.

As we explain in our report, there were several areas where we did not accept the FA's methodologies and judgements. The key areas of difference are for private passenger automobile, the selection of the loss development factors for private ... for bodily injury coverage, and for commercial automobile, the selection of the bodily injury loss trend rate.

So based on our alternative methodologies and judgements, we derived rate level indications that

are 17 points and 18 points less than those derived by the FA for private passenger automobile and commercial automobile respectively.

MS. NEWMAN: So with respect to the loss development factors for bodily injury coverage, you've just explained that the primary difference between the private passenger automobile rate level indication calculated by FA and that calculated by Mercer was explained by the loss development factors. Would you please detail these differences and, you know, in particular what are they and how you arrived at your conclusions?

MS. ELLIOTT: Okay, well let me begin again by reviewing the purpose of loss development factors. The FA, what they're trying to do is project what its losses will be over the period that the rates that they're proposing are to remain in effect, so as filed this is a period spanning February 1st, 2003, going out to January 31st, 2004. That's assuming a 12 month policy and that there won't be another rate filing in between, but to project the losses that will arise during this period, put simply, the FA looks back at the average amount of losses that have occurred during the period 1997 through 2001, but in doing so, an adjustment must be made to those loss results. These claims that have occurred during the past five years have not all been settled, and so the amount of losses that will be paid on those claims must be estimated. This is done through the application of loss development factors.

There's a second adjustment that must be made and I'm going to discuss this later, and this second adjustment is to reflect the fact that the conditions that have given rise to those losses over the past five years have changed. This adjustment is made through the application of the loss trend factors, but right now let me focus on the loss development factors. So the issue ...

MR. O'FLAHERTY: Mr. Chairman, I'm sorry to interrupt the witness, can I just ask that the witness just give her testimony a little slower because I'm just trying to jot down a couple of notes here. Thank you.

MS. ELLIOTT: So the selection of loss development factors is a matter of actuarial judgement. FA exercised judgement in deciding what historical loss development factors to include or exclude in the averages that it selected. As a general rule we accept the use of judgement in selecting loss development factors but we have a concern with the judgement applied by FA in selecting the loss development factors that it uses.

First, in every instance where FA elected to exclude a historical factor or factors from the average selected, the factor or factors they excluded were always the lowest.

Second, FA's basis for deciding what factors are outliers is not consistent. In some cases they looked to older history to justify labelling a factor an outlier, and in some cases they do not.

In some cases they look to history to justify not considering a factor an outlier and in some cases they do not. In some cases they give more credence to a factor that occurred recently, and in some cases FA does not.

It is this inconsistency in deciding what factors to call outliers and therefore exclude from their averaging, and the fact that in every instance the factor or factors FA decided to call an outlier and therefore exclude from the average was always the lowest factor or factors, and the fact that by excluding the lowest factor, the rate level indications are raised, that causes us to question the appropriateness of the selected loss development factors.

So let me show you a graph so you can see what I mean. We have had some charts handed out.

MS. NEWMAN: Yes, we have circulated a package of charts, page 1 to 19, I would call that PLE-4, and I would also note that the page references are those at the top. Your copy may have a number at the bottom of the page which should be ignored. So everybody has a copy of that, you can proceed, Ms. Elliott, to explain what this all means.

EXHIBIT PLE-4 ENTERED

MS. ELLIOTT: I'm afraid I'm having a technical difficulty here.

MS. NEWMAN: Okay.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, here we are.

MS. ELLIOTT: So this first exhibit, the first graph, what I wanted to provide ... I should keep this close ... what

I wanted to provide for you is graphically ... so you have a picture, and I know we've covered this before, but I wanted to be able to show you the points that were included in the average, they're the black dots, and the red dots represent the points that have been excluded from the average. The blue line represents the straight five year average.

MS. NEWMAN: So this is not the average that was adopted by FA.

MS. ELLIOTT: Correct, it is not showing the average that was necessarily adopted by FA, so we'll start with 12/24, for example. In this case we see we have this high point up here. It was included in the average, and these points below, it was included, and in fact, for this particular case the average was a five year average, the straight average was selected by FA ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Would you again repeat what the black ... I'm sorry, are they black or blue?

MS. ELLIOTT: Well, I only have two colours so black but ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, would you repeat what it is they mean?

MS. ELLIOTT: They represent the actual loss development factors for the last five years, the last five points. Perhaps I'm going to suggest if we could open up to page 4.4.

MR. SAUNDERS, PRESIDING CHAIRMAN: In?

MS. ELLIOTT: Of the FA application.

MR. SAUNDERS, PRESIDING CHAIRMAN: That's Appendix A?

MS. ELLIOTT: Appendix A.

MR. SAUNDERS, PRESIDING CHAIRMAN: 4.4. Okay.

MS. ELLIOTT: So, okay, so on page 4.4, the column labelled 12, or 24/12, you'll see the first, the bottom point, the 1.4106.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MS. ELLIOTT: That's this point up here.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MS. ELLIOTT: The other points, the remaining four points here reflect the other four points, so we're showing the last five loss development factors in each column, and again ...

(11:45 a.m.)

MR. STAMP, Q.C.: Mr. Chairman, I'm sorry, I didn't catch where these points are that were being referred to us?

MS. ELLIOTT: Well, we can walk through them. The first one is 1.4106, we have a point of 1.823. We have a point of 1.0858, that's over here. We have a point of 1.558, it's probably in here, and a point of 1.212. So they're the last five data points in that column on page 4.4 under the 24/12 column.

MS. NEWMAN: So this is similar to the graph that would have been provided by Mr. Pelly in his BGP-3, his package of graphs.

MS. ELLIOTT: It is.

MS. NEWMAN: Can you please highlight the differences for us so that we might ...

MS. ELLIOTT: So here ...

MS. NEWMAN: Would be the graph at page 12, perhaps. Do you have a copy of those package of charts?

MS. ELLIOTT: No, not at this table here.

MS. NEWMAN: Okay, I believe it's page 12, is that the comparable graph?

MS. ELLIOTT: It's similar on the graph that was produced by FA on page 12. They also show the selected value, so they have there various exhibits, but what we're trying, we're trying to simplify the picture here. We've only shown the five year average, the straight average, as calculated and provided by FA. We've shown the points that they've calculated, the loss development factors each of the last five data points that was provided on page 4.4, and then in red we've excluded, we've shown the point that has been excluded by FA in each of the columns.

MS. NEWMAN: And the straight average that is shown in blue, that is without data point exclusions?

MS. ELLIOTT: That's correct.

MS. NEWMAN: So this is what the straight average would be if there were no exclusions?

MS. ELLIOTT: Correct, no exclusions, just the straight average as provided on page 4.4, the five year straight average.

MS. NEWMAN: And whereas the average on the chart provided by Mr. Pelly is a straight average with exclusions, am I correct in saying that?

MS. ELLIOTT: Well the points selected by Mr. Pelly, the red line, would reflect exclusions that he would have made to estimate his, to provide his selection.

MS. NEWMAN: Okay, and there's more data points on the graph provided by Mr. Pelly as well. The dots in yellow do not appear to be on your graph?

MS. ELLIOTT: No, no, we simply really want to focus in on the issue here, which is the data exclusion, so in this particular case we have a high point, it's not excluded from the average. The next column the 36/24, we have this point down here, it's excluded. We look here and we have points above, below, these are excluded. Again, a point here, points above, but only the points below are excluded. Okay, I'll walk through a few more for you. The next coverage we can talk about is private passenger accident benefits, so again we see these are the points that were provided, the last five data points, and we have this one way up here but it's still included, it was not excluded by Facility Association. The next column, the 36/24, we have this point down here, not that far from the average compared to here, but it's excluded, and another exclusion back here.

We'll go over to commercial BI, in this case we see an exclusion out here at 48/36, this data point.

MS. NEWMAN: Is this page 3?

MS. ELLIOTT: Page 3, this data point has been excluded whereas this other, at the opposite end of the spectrum, has been included, and we just wanted to show you for the next three development intervals, the next page, here again we see here the various data points, but FA ... and again, we have the five year straight average along here, but FA judgementally selected a number, 1.05 in this case, which is above their five year average. Again, in this column here's the five year average, here's the data points, they judgementally selected a number slightly above that five year average, the same here. This yellow dot represents the selection that was made. There were no exclusions provided, just a judgement number was selected.

And I'll show you one more graph related to these exclusions, this exclusion issue, and again we see the points above the line, we see the points below the line, so for commercial vehicles, property damage, again, these points were excluded, these were included, and again we have the five year straight average. So I'll carry on on the issues with loss development.

MS. NEWMAN: So you preferred the weighted average over the straight average?

MS. ELLIOTT: Yes, we prefer to use a five year weighted average. In our view this is more typical of what we see and contrary to what Mr. Pelly has stated, it is the more responsive method here for ... now, I'll give you an example, so the issue of responsiveness is another area where FA exercised judgement by using the straight average. There has been considerable testimony on this issue so I won't repeat all that here, but I wish to point out that for private passenger, bodily injury coverage, of the 15 development factors that need to be selected, you know, we saw these on page 4.3, and we have that open ...

MS. NEWMAN: So those are the columns, 12, 24, 36?

MS. ELLIOTT: Right across, there's 15 of them.

MS. NEWMAN: Right.

MS. ELLIOTT: We see that the weighted average produces a more responsive result than the straight average in 14 of the 15 cases.

MS. NEWMAN: And was that all the comments that you wish to make in respect of the loss development? I think that we've heard lots about that so far in this proceeding.

MS. ELLIOTT: Yes, we are trying to present it here as the issue of data exclusion, the judgement that was

applied. I hope that I've shown it graphically that everybody understands the issue, so yes.

MS. NEWMAN: Okay, so then I'd like to move on to the issue of loss trend. I understand that it's another major reason for the difference between the rate level indications, particularly for the commercial automobile coverage. Is that true?

MS. ELLIOTT: Yes, that is true.

MS. NEWMAN: Would you please detail the difference between your conclusions and those of FA please, explaining why you prefer your approach?

MS. ELLIOTT: Let me begin again, I will review the purpose of loss trend, and I know you've heard this over the last couple of days and last week. As I explained earlier, the FA is projecting what losses will be over the period that these proposed rates will be in effect, so when they filed it, this would be starting February the 1st, 2003, so to project the losses that were (inaudible) during this period, so simply FA looks back at the average amount of losses that have occurred during 1997 through to 2001, but they make adjustments for those loss results and I've already spoken about loss development, and the second adjustment that must be made is to reflect the fact that the conditions that have given rise to those losses over the past five years have changed. Now this adjustment is made to the application of trend factors, and the trend is often reviewed by splitting the study into severity, what the average costs are, and the frequency, how many claims per (inaudible) vehicles, but within loss trends we have four areas of concern ... the accident half year versus a full year data, the number of years that are considered, the unemployment rate, and the selection of flat trends, so I'm going to go through each of these issues and explain.

Now, on accident half year data, this issue, we suggest that accident half year data provides more information and insight into the data, so just like when FA analyzed loss trend, it separately analyzed frequency and severity for insight into the data. The use of the half year data better allows us to identify outliers and allows us to exclude the half year data point that is the outlier as opposed to having to exclude a full year of data, which may include a point that is not an outlier, and where this became very important is in the commercial auto BI coverage. Now let me pull that up for you here. Okay, so what I've provided here on the screen for you ...

MR. STAMP, Q.C.: Do we have this page?

MS. NEWMAN: Yeah, I'm just going to give the page reference, page six, I believe is the page reference for that.

MS. ELLIOTT: We're running, we're preparing this regression analysis on the loss cost data, and this is this column here, the estimate of the ultimate loss cost. These two points are the point in question. We have the winter of 2000, the second half of 2000, and the first half of 2001. This is the data that's being referred to. We spoke yesterday about the large increase. When we look at the 409 to 691, there was a reference, I believe Mr. Pelly stated yesterday the increase was approximately 69 percent, and the same when we're looking at this data point here, the first half of 2001, of 2000, to the first half of 2001, this change here was roughly 41 percent higher so we believe the unusual winter that has occurred during this time has artificially increased the loss trends, and it distorts it, so if we include these data points, the annual loss trend rate increases to 11.3 percent, without these data points the trend is 8.4 percent. So here, I'll show you down below, our fit ... the loss trend when we exclude these data points is 8.4 percent, and I'm going to put ...

MR. STAMP, Q.C.: Just for clarification, Mr. Chairman, I don't believe the page I'm looking at, page 6, is the page that's on the screen.

MR. SAUNDERS, PRESIDING CHAIRMAN: No, it's not, Mr. Stamp. That's the same in my case. Those numbers don't ...

MS. ELLIOTT: You might be seeing this page.

MR. STAMP, Q.C.: Yes.

MS. ELLIOTT: On your screen. Here what we've done, we've included these two data points. Again, the area that's highlighted in blue is all used in the regression analysis. We've included these two data points that we excluded previously, the winter, the famous winter, and when we include those two data points our regression analysis is ...

MR. GOODLAND: I'm sorry to interrupt, if Ms. Elliott could slow down a tad because the numbers are kind of

small on the screen and we're trying to cross-reference them. I'd really appreciate it. Thank you.

MS. ELLIOTT: So in this particular case, what you have on the screen in front of you is the inclusion of the winter of 2001. When we include these two data points our regression analysis tells us that the annual rate of change is 11.3 percent. What I just showed you moments ago is when we exclude them, the loss trend rate is 8.4 percent. This is a significant difference to be caused by the inclusion of two data points. Further, this high trend is very different than the private passenger trend of 7.1 percent that we estimate, and intuitively this does not seem reasonable.

MR. SAUNDERS, PRESIDING CHAIRMAN: May I stop you there for a moment. The sheet showing the 8.4, is it, you said?

MS. ELLIOTT: Yes.

MR. SAUNDERS, PRESIDING CHAIRMAN: We don't have that, do we?

MS. ELLIOTT: That would be provided in the response to FA's question number two.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, can we then refer to that to give everyone an opportunity to find the numbers that you're referring to and make the necessary mark on it, I guess. In response to what question, was it?

MS. ELLIOTT: I believe it's ...

MS. NEWMAN: FA No. 2.

MS. ELLIOTT: I believe it's number two or number ... it's FA No. 4.

(12:00 noon)

MS. NEWMAN: It would appear to be at page 4 of FA-4 in the exhibit section. So it should have in the top right-hand corner of the binders upright, FA No. 4 exhibit, page 4, our response.

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

MS. NEWMAN: Okay, I believe everybody has that now.

MR. SAUNDERS, PRESIDING CHAIRMAN: If you're going to refer to any other sheets, maybe a little advance notice would be ...

MS. NEWMAN: We'll try and do that, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, that would also have the tendency to slow down the witness.

MS. NEWMAN: Kill two birds with one stone.

MS. ELLIOTT: Well, let me repeat. If we include these two data points from the winter, the annual loss trend rate increases to 11.3 percent.

MS. NEWMAN: And that's on page 6 of the charts that were provided.

MS. ELLIOTT: I'm sorry, on the screen (inaudible) charts, and without these two data points the trend is 8.4 percent.

MS. NEWMAN: And that's in FA-4, page 4.

MS. ELLIOTT: Thank you. This is a significant difference to be caused by the inclusion or exclusion of two data points. Further, this higher trend is very different than what we see for private passenger, again, the same drivers on the roads in commercial and private passenger. Private passenger we had a loss trend we estimate of 7.1 percent. So intuitively, an 11.3 percent trend does not seem reasonable, and when we exclude what we believe is a result of the winter, the famous winter, the loss trend reduces to 8.4 percent.

MS. NEWMAN: Now, Mr. Pelly had questioned the use of the seasonality, I believe, because of T test standards that he had an analysis to be done on those.

MS. ELLIOTT: Right, Mr. Pelly questioned the use of seasonality because it did not meet his T test standard in some cases, so first seasonality can be seen graphically, so while we use a T test to see the statistical significance, it does not take a statistician to see a graph going up and down and know that it is the seasonal nature of the first half versus the second half of the data. I smile because I look out the window, but ... okay, I'm afraid I don't know the page number of this, Ms. Newman, maybe you could help me here.

MS. NEWMAN: Okay, those graphs appear to be on page 7.

MS. ELLIOTT: Uh hum, this is private passenger bodily injury, the graph.

MR. STAMP, Q.C.: Page 9.

MS. NEWMAN: Page 9?

MR. STAMP, Q.C.: Do we look at page 9 or page 7?

MS. NEWMAN: It's page 9.

MR. STAMP, Q.C.: We don't have copies with the colours, do we, Ms. Newman, available to us?

MS. NEWMAN: It appears that these copies are not colour.

MS. ELLIOTT: No, my point is up and down, the colour isn't too relevant. I hope you can follow on the screen.

MR. STAMP, Q.C.: But when you turn the screen off I won't be able to see it anymore.

MS. ELLIOTT: I'll keep it on for you for a while if it helps.

MR. STAMP, Q.C.: Tonight?

MS. NEWMAN: You can always come back, stay here. Is it possible for us to get ...

MR. SAUNDERS, PRESIDING CHAIRMAN: I notice the colour shows up on the earlier charts in PLE-4. Did we use a different copier to copy page nine than page one?

MS. ELLIOTT: Yes, a photocopier was used, I believe, when these were printed off as opposed to directly ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Because, you see, as Mr. Stamp points out, reading it from the hard copy you can't tell the ultimate from the fitted line because both are solid.

MR. WHALEN, Q.C.: Yeah, colour is back again on page 16, but it's gone by page 17, so ...

MS. NEWMAN: Ms. Elliott, is it possible for us to provide colour copies of this document, do you have it on ...

MS. ELLIOTT: Yes, it would be, yes, yeah.

MS. NEWMAN: Yes, we have it on disk, so we can print it out on the colour printer and provide it to the parties later on today, but for the purposes today we should be able to look at the screen.

MR. SAUNDERS, PRESIDING CHAIRMAN: Is that ...

MR. STAMP, Q.C.: If we could have it before we go, Mr. Chairman, it would be helpful.

MR. SAUNDERS, PRESIDING CHAIRMAN: Sure, okay. Carry on.

MS. ELLIOTT: Okay, so what I wanted to say here is that seasonality, it can be seen graphically, you can see the graph going up and down. So secondly, we can, we can have seasonality pass FA's T test standard by simply adding more years to the history that is considered. For example, Mr. Pelly cited private passenger BI as an example where seasonality did not meet his T test standard, FA's T test standard, so what we've ...

MR. STAMP, Q.C.: I'm sorry, what was that, was that commercial BI that was referenced?

MS. ELLIOTT: This is private passenger bodily injury.

MR. STAMP, Q.C.: Private passenger, thank you.

MS. ELLIOTT: So we can see the data is clearly going up and down. Our regression model that we ran with ten years of data had a 90 percent value for the T test statistic, so what we've done here is we've gone back the extra two years starting as FA did in 1990, then the seasonality is significant under FA's 95 percent T test standard and actually it's almost 98 percent level. So, however, when we do this, when we go back the extra two years, we end up with a higher loss trend rate when we go back the extra two years, so ...

MR. STAMP, Q.C.: Mr. Chairman, I'm sorry, is this on the chart we're looking at? I'm supposed to follow this?

MR. SAUNDERS, PRESIDING CHAIRMAN: I find it difficult as well because I don't see, when you ... see I

don't know what that red line is or the blue line is, is that your problem?

MR. STAMP, Q.C.: I don't know what ... no, Mr. Chairman, that too ...

MR. SAUNDERS, PRESIDING CHAIRMAN: I can't tell from this.

MR. STAMP, Q.C.: That too, but I don't know, Ms. Elliott's been referring to a number of percentages, T test percentages and so on and I don't know if she's reading it from the chart, can we see it, or is it just she's recalling that that's what the situation is. I don't know.

MS. ELLIOTT: I'm telling you what the situation is.

MR. STAMP, Q.C.: Okay, that's helpful.

MR. SAUNDERS, PRESIDING CHAIRMAN: How long would it take to provide the colour charts in the hard copy?

MS. NEWMAN: Yes, Mr. Chairman, I'm just thinking we could probably take our break now because it's ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes, I think that might be a good idea.

MS. NEWMAN: And then we'll get these colour copies and everybody will have them on hand.

MR. O'FLAHERTY: Mr. Chairman, and I don't want to muddy the waters any further, but I think, I too think it would be helpful if there was reference being made to certain results of T tests, etcetera, if that information ... because I think sometimes it's up in the corner of the screen, if it's on that same page, if we could be told where that is, that would be helpful for me too to process the information.

MR. SAUNDERS, PRESIDING CHAIRMAN: You're asking the witness to be a little more detailed in terms of her ...

MR. O'FLAHERTY: It's an area, you know, it's an area that ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Yeah.

MR. O'FLAHERTY: ... we're still growing with, you know, so ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes, yeah, if you haven't constructed the charts yourself it's very difficult to follow a quick explanation of it, yeah, I agree. Okay, we'll break until 12:30.

(break)

(12:45 p.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, are we ready to proceed?

MS. NEWMAN: Yes, we are, Mr. Chairman, I just wanted to advise everybody and the record that those graphs that have been provided as PLE-4, was it, some of them are in colour, some of them are not. We are endeavouring to get colour copies of the remainder, though it's not possible for us to get copies right now so we'll undertake to get them to the parties hopefully this afternoon, barring any unforeseen difficulties with that. I have spoken with the parties and they are prepared to proceed on the basis of the screen. They are colour on the screen as has been shown, so I would propose to start back in on the topic of accident half year data, if everybody is prepared.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay.

MS. NEWMAN: Now, Ms. Elliott, we spoke a little bit already about the accident half year data, and I think that you've highlighted for us the effect of the exclusion of the data points and I wanted to start first with asking you to please explain what is seasonality?

MS. ELLIOTT: When we review the data in our loss trend regression work, we're using half year data, and seasonality comes out such that you have the first half of the year and we have the second half of the year, and seasonality would refer to perhaps the first half is always higher than the second half, and then when you go to a graph, which we'll get to shortly, you would see spikes in the graph as it goes up for one half, and down for the second half, and up for the first half, down for the second half, so it's up and down nature due to the differences in the experience between the first half of the year and the second half of the year, so this reference is known as seasonality in the data.

MS. NEWMAN: Perhaps we can look at a graph, if you have one there, to see this difference.

MS. ELLIOTT: Okay.

MR. STAMP, Q.C.: And this matches which, Ms. Newman, please?

MS. ELLIOTT: It's reference from page 9.

MS. NEWMAN: So can you please explain what the first graph there represents?

MS. ELLIOTT: Right, this is the loss cost experience of private passenger automobile bodily injury, this first graph. The second graph is for claims severity, and that represents the average cost of each claim and then the claim frequency per thousand, how many claims have occurred per thousand vehicles.

MS. NEWMAN: So would that first graph then be the total of the second two graphs, a meshing of the two that follow?

MS. ELLIOTT: It is a merging of the two.

MS. NEWMAN: Uh hum.

MS. ELLIOTT: Essentially mathematically, claims severity times claim frequency equals loss cost. Now in this particular graph we're focusing on loss cost, and this particular page, along this axis here, we're seeing the loss cost values, and along here is the timeline. We've started in this particular case at 1990, so we have the first half and then the second half, and so all the data points that we're referring to here is the first half of the year, the second half of the year. The pink line is the fitted line to the data and the blue line is the actual data.

MS. NEWMAN: Okay, so by fitted you mean ...

MS. ELLIOTT: Fitted is the results of the regression analysis, so when we prepare the regression analysis, what you want to do is come up with a change period over period and the fitted values then reflect that change period over period that have been estimated.

MS. NEWMAN: Okay, so this pink line demonstrates the results of your regression analysis for seasonality?

MS. ELLIOTT: It demonstrates the results of our regression analysis here again starting with 1990 data out to 2001 data and the pink line shows the fit when we use that period of time. Now what I wanted to point out here is that when we prepared our study we used ten years of data for the bodily injury loss cost trend, so we start with the 1992 experience out through to 2001, and we use half year data.

MS. NEWMAN: Okay, so while this graph starts at 1990.1, which would be the first half of 1990, your regression analysis would not include the data up to 1992, it's only from 1992 forward.

MS. ELLIOTT: That's correct. What previously Mr. Pelly had questioned the use of seasonality because it did not meet one of the statistics that is used in regression analysis, a T test, so what I wanted to show you with this graph is that we can see seasonality and I also went back to 1990, that's the period of time that Mr. Pelly had started his analysis. He used 12 years of data, where we use 10 years of data, year after year, we use 10 years of data, and when I go back to 1990, we have a value here, this is the seasonality, this is a seasonality statistic. Now, it's a statistic that then we reference into T test tables which I don't have here, but I will tell you that that result of this test shows that seasonality is significant and, in fact, at 98 percent level which is in excess of the 95 percent value that has been put forth by FA. So what we've been able to show you here is that we do see an up and down nature, a seasonality in the data that if I use ... just go back two extra years, I get a T test that is in excess of the threshold that has been presented by FA, the 95 percent, and in fact on the period of time that we had used in our recommendation, ten years, the threshold for the T test was meeting a 90 percent criteria. But also when you go back these additional two years, the loss trend is higher. FA estimates a BI trend of 7.5 percent, we're estimating 7.1 percent based on ten years, so I too, if I go back and use 12 years of data like FA, the trend that we would estimate is higher, over 7.5 percent.

MS. NEWMAN: Okay, and is that on this chart here, on this page?

MS. ELLIOTT: I'm going to ... page eight.

MS. NEWMAN: So what does this 7.5 represent?

MS. ELLIOTT: This 7.5 percent represents the result of the regression analysis using in this case, like FA, going back to 1990, we get a higher trend, we get 7.5 percent, and the T test criteria is met, so if we go back in time the T test standard is now met by the threshold presented by FA of 95 percent. It's 98 percent. But what we're trying to express here is that we believe there is seasonality in the data. You can see it

graphically. You can go back in time and increase the T test statistic and say, gee, it has a higher result and then be confident that there is seasonality in the data, so we say there is seasonality in the data here.

MS. NEWMAN: But you get a better T test when you use more years. Why didn't you use more years?

MS. ELLIOTT: We like to use ten years of data. For this particular coverage we feel that the loss experience in the older years, most have settled, they're reliable. We like to be consistent from year to year and use ten years. We are quite comfortable that there is seasonality in the data. We wanted to measure that as one of the variables in the regression model, and have done so. So we believe that there clearly is seasonality in the data, that you can see it graphically. You can go back in time and make it significant. But rigidity to T test standard doesn't always allow you to be meaningful in the regression model that you're selecting.

MS. NEWMAN: So it appears to me as though you, similar to Mr. Pelly, adopted a regression analysis that's lengthy but used your judgement to feel that a ten year period is more appropriate in the circumstances.

MS. ELLIOTT: That's correct, that's our consistent basis. So I want to summarize here that we believe the use of the accident half year data is justified. It provides more insight and information into the data and that it's statistically justified.

MS. NEWMAN: Mr. Pelly had suggested that he felt that it wasn't appropriate to use seasonality or half year data because he felt that it introduced too many variables, noise I think he spoke of, into the analysis. Can you speak to that?

MS. ELLIOTT: Yeah, let me speak to the noise issue that Mr. Pelly raised. So we tested various examples before the exclusion of data points, so we looked at the trend that you would derive from accident half year data and when I merged the data, the same data into annual data points, so I just take each half year, put it together in the annual data, so when I do that I essentially derive the same annual trend rate, whether I use half year data or whether I use annual data. So using half year accident data does not create noise that would lead to an incorrect estimate of the annual trend rate.

MS. NEWMAN: So when you were making this comparison did you have any exclusions in either of those data or did you use a full data set?

MS. ELLIOTT: We did both bases. We tried ... obviously with the annual data it's not when you have half year data and I might have excluded a half year point and when I had annual data, not excluding the point, so we looked at various cases so essentially if you just take the data, ignore the exclusions and run the data through, you get the same result, but you get the extra insight when you have half year data. You get to see the outliers often more clearly and only exclude that half year that's the outlier, not the full year.

MS. NEWMAN: So what were your conclusions with respect then to the use of half year data after doing that analysis?

MS. ELLIOTT: So firstly the use of half year data does not affect the findings of the annual loss trend rates. It allows the user to observe any unusual data point more closely than annual data, and without this observation of the data the exclusion of the data from the winter that we've spoken of, the winter of 2000/2001, we find that the commercial BI trend as estimated by FA to be high.

MS. NEWMAN: I think the next point that you had said you wanted to address was the number of years of data. Can you please explain your approach with respect to the number of years?

MS. ELLIOTT: Sure. So when we prepare our regression analysis, in this particular case the data that's available to us is the AIX 2001 data, and we generally use ten years of data, so in this particular case we would use from 1992 to 2001, and we use ten years of data for bodily injury, and this is a major coverage, and we use that for both private passenger and commercial. That would be our starting point. We use ten years of data for severity for physical damage coverages and we use five years of data for frequency for the physical damage coverages, and I'll explain more a little bit later why we use five years for this particular coverage, some of the things that we're seeing, and in our, our issue that we're raising here on the number of years of data, we see that FA goes back to 1984, they go back 18 years in some cases, and we suggest that FA's approach that goes back in time to 1984 is not responsive to the current environment. So as I said earlier, we're trying to adjust the 1997 to 2001 accident year losses to the cost level that's expected under the

new rate program that FA wants to implement in 2003, so the changes in cost that have taken place since 1984 may not be relevant for this purpose. We're not trying to project 1984 data. We're not using 1984 data in terms of projecting what the cost will be. FA uses 1997 to 2001. They are the accident years that they're trying to project forward, so life today is not necessarily like life in 1984. I want to refer back to our report, the information that we provided on page 15.

(1:00 p.m.)

MS. NEWMAN: Page 15, you say?

MS. ELLIOTT: Yes, page 15 of the Mercer Report.

MS. NEWMAN: There's a series of three charts, three levels of charts, two on each level. Can you explain that for us?

MS. ELLIOTT: Right. What we've provided here is the severity information for three coverages, the property damage tort, the physical damage, collision severity, and the comprehensive coverages, and we've shown it for the last five years, 1997 to 2001, because remember that is the actual accident year data that's being projected forward to determine the cost, the premiums for this FA rate proposal. So the actual data, this represents the actual severity, in this case the PD for 1997, the actual amount, the average cost is $2,416. In 1998 the cost, the actual cost was $2,600, and so on. The next column beside that is FA fitted debt (phonetic) results from its regression model.

MS. NEWMAN: And you spoke briefly what that meant earlier with respect to that graph. Can you refresh our memory as to what ...

MS. ELLIOTT: Let me just take you back here. This isn't the same data but I'm just on page eight, but we're looking at ... and I have a blue, well, I guess it's purple on the screen, I have a purple column and a white column, if you will. That purple column is the actual data.

MS. NEWMAN: So that's the ultimate loss cost?

MS. ELLIOTT: Right, and it's the estimate ultimate loss cost, and we call that the actual data. The next column beside is known as the fitted data. That's the result of the regression model. So once an annual rate of change is estimated, it applies that change period over period in the model, so that's what the fitted values refer to, okay?

MS. NEWMAN: So we're back on page 15 now?

MS. ELLIOTT: We're back on page 15. So the fitted is the result of the regression model. So in the column titled "Difference," we're just subtracting the difference between the fitted value and the actual value, and you see we've summed this difference, $602. So if you're to look at a graph, you would expect the actual data and the fitted data to be wide apart, if you will, because of this difference. Further to the right is Mercer's evaluation, again the same actual data we've provided here, and then Mercer's fitted value, and again you can see the differences, so essentially, looking at it graphically, Mercer's data is closer to the fitted values.

MS. NEWMAN: Now, Mercer's data would have been based upon ten years?

MS. ELLIOTT: Mercer's data is based on a ten year regression analysis for the severity data for each of these three coverages.

MS. NEWMAN: Okay. And FA's are based on a different period, are they?

MS. ELLIOTT: Well, if we refer to page 14 ...

MR. STAMP, Q.C.: Of which document, please?

MS. ELLIOTT: Of the Mercer document, the Mercer Report. So in the chart, in the middle of this page, we've provided for each coverage and we've broken it out as the analysis has been presented by FA into severity, frequency and loss costs, so on page 15 we're looking at the PD, we're looking at collision and comprehensive. They're the three coverages that we're focusing here. So in this particular case for severity FA is using 18 years of data. If you look under the severity column it's 18 years, 1984 to 2001, same for collision, and there's a couple of data points excluded for collision here, and same for comprehensive. Okay. So we can ...

MS. NEWMAN: And under frequency, these different years, numbers?

MS. ELLIOTT: Frequency again FA has a variety of selections here ranging from 18 years to 12 years and various exclusions, and I think as I mentioned earlier,

for bodily injury it's prepared on a loss cost basis and 12 years of data are used, 1990 to 2001.

MS. NEWMAN: Is that the same as your time frame then?

MS. ELLIOTT: No. What we use is ten years of data for bodily injury, but that just gives you some background on the time periods that are used by FA, but let's get back to where we were on the differences.

MS. NEWMAN: At page 15 again.

MS. ELLIOTT: Page 15. So what we wanted to present here are the actual data, then the fitted data from FA's model, FA's last regression analysis, and Mercer's regression analysis. Now, in each case here we've listed the annual trend. FA's annual trend for PD is 4.3, Mercer's annual trend, 2.5, collision, severity, again 4.7 for FA, Mercer is 2.9. Comprehensive, we're very close here, 3.6, 3.5.

MS. NEWMAN: What does all this mean then?

MS. ELLIOTT: Well, what we're trying to compare here is the difference. We can look at R squared statistics, we can look at T test statistics, but really what you want to look at is what is the difference? Here's your actual data that you're going to use to project forward to try to develop your premiums, estimate what your rate level should be, and you're using a regression model to develop fitted values to say this is my change year over year, and if that was ... the best measure, one way to look at it here, is to say, well, how far is this actual data from the fitted curve, and with this higher trend rate, the 4.3 as an example for PD, the difference is added up to $602. Under Mercer's fitted value the difference is only $74. Similarly for collision, the difference is $1,362, Mercer's is minus seven. And where we have similar trends on comprehensive, 3.6, 3.5, the differences are minimal here. So what we're trying to point out here is that using a shorter time period, the ten years, we think that we're getting a good fit to the data, that we don't have to go back to 1984, we don't have to go back 18 years, and in every case, in all of these three cases that we're seeing here, Mercer has a lower R square, so should we be overly concerned about the R square? I don't think so and I'm going to explain why. So we heard Mr. Pelly say a lot about the importance of R square, R square values, and we don't deny that R square values are important, and just to remind everyone, the R square just shows how much variation there is from period to period, and that's explained by this R square value in the regression analysis. That's simply all it means. But R square values, while they're important, they are not the final or overriding determinant of an appropriate regression model. I'm going to give you two examples. I want to look at a real life practical example. I'm going to point you to the paper here, page 16.

MR. SAUNDERS, PRESIDING CHAIRMAN: What reference was that again, Ms. Elliott?

MS. NEWMAN: We're at PLE-4, so that's the package of charts and tables that were provided.

MR. SAUNDERS, PRESIDING CHAIRMAN: 16?

MS. NEWMAN: Page 16.

MR. SAUNDERS, PRESIDING CHAIRMAN: Good.

MS. ELLIOTT: So this graph that you should have in front of you in colour and on the screen is the Standard and Poor's Index, and we've gone back to 1984, so ...

MR. SAUNDERS, PRESIDING CHAIRMAN: You say it's the Standard and Poor's 500 Index?

MS. ELLIOTT: Correct, yes.

MS. NEWMAN: Is that the blue line?

MS. ELLIOTT: Well, on this the blue line is the actual data and the red line is the fitted data, so along the X axis here we have 1984, we've gone through 2001, and along here we have the values from the S&P 500 Index. So what we wanted to show you was that the fitted line is quite good, along here we go back to 1984, but then life is changed up in here. It's not a very good fit at all.

MR. O'FLAHERTY: Mr. Chairman, can I just stop the witness for one sec? When she's using the cursor on the screen, she's describing it by saying here or it or this shows this, and when we read the transcript we won't be able to pick up this ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Good point.

MR. O'FLAHERTY: ... distinction, and I'm wondering if, where she's using the cursor, she can actually describe

what we're seeing so when we read it afterwards we can, it'll make sense to us.

MR. SAUNDERS, PRESIDING CHAIRMAN: Good point. Is that a problem?

MS. ELLIOTT: No, thank you. So let's look here. Here's the pink line, 1997. We can see the blue line, the actual data, is higher, and we can see past 1997 there's a widening gap between the pink line and the blue line, and in particular we see at 2000 they cross going in a completely different direction.

MS. NEWMAN: So this blue line which represents the actual data has dropped.

MS. ELLIOTT: That's correct, and we all know the market is changed. So this graph ... I believe this exhibit is page 19, so we jump from page 16 to 19. This graph has a very nice R square. It has a 97.3 percent R square and the time, T statistic is very high at 24, so this time test, R exceeds the 95 percent standard, and the annual rate of change that we see that's derived from this model with this high R square of 97.3 percent is 16.4 percent per year.

MS. NEWMAN: And that's shown where on this table at page 19?

MS. ELLIOTT: 16.4 is shown here under the time coefficient, 16.4 percent.

MS. NEWMAN: Okay.

MS. ELLIOTT: The R square is shown here in the T statistic for time, the one variable that's used in the model. I'm going to go back to the graph. So here we have this chart. It indicates a 16.4 percent annual rate of increase with an R square of 97 percent, and the T test is more than acceptable, so now I ask you, how many people in the room have realized an average of 16.4 percent in the last couple of years or would anyone project 16.4 percent next year? I think this is a good example of how an R squared statistic in a T test could be misleading. I want to give you another example. I want to give you an example where the data is very consistent but it's essentially flat. Bear with me here, I'm just trying to find the graph for you. I believe on page 17 of the exhibits that we've been in you'll find this graph. Here's an example where the data is very consistent and by looking at this ...

MS. NEWMAN: What does this graph show?

MS. ELLIOTT: Well, this is just data that we've selected. Again, the blue line is the data and the pink line is the fitted value, so I'm just trying to talk about R squares and their value, their relevance, from looking at graphs, and (unintelligible) look at this and say, oh, gee, the data seems to be really close to this fitted line. You know, I'm a lay person, I guess that has a great R square, just, you know, that's great, I couldn't ask for more, couldn't be happier. Well, in fact, this has an R square of nearly zero. I'm going to jump over. Again I'll point you, I believe it's all in the same, on the same page that you have.

MS. NEWMAN: Yeah, it's on page 17, just at the top here.

(1:15 p.m.)

MR. STAMP, Q.C.: Mr. Chairman, could we have the source of this data so we can do our own review, if we wish? We can check Standard and Poor but we can't check this. We don't know what it is.

MR. SAUNDERS, PRESIDING CHAIRMAN: What's the source of this data?

MS. ELLIOTT: It is just artificial data. We are just trying to show the results when you have flat data what happen ... the data is provided on page 18. So the R square in this case is essentially zero. It's 0.8 percent.

MS. NEWMAN: So we see that on the hard copy, just in the top left-hand corner of the sheet, page 17?

MS. ELLIOTT: That's correct.

MR. SAUNDERS, PRESIDING CHAIRMAN: So it's a hypothetical case, is it, we're talking ...

MS. ELLIOTT: It's a hypothetical example, so what we wanted to show you is that you can have graph, here's the data, looks like it's fitting the line very well ...

MS. NEWMAN: And the data is in blue.

MS. ELLIOTT: The data is in blue, the fitted line is in pink, and a layperson, for the dialogue that we've had here on R square, you'd think, well, that looks pretty good, you'd expect a high R square, but in fact you don't get a high R square. It's essentially zero. And it's

the nature of an R square to be very low when you have a flat curve. There's little change period to period. And in fact that's the type of data that we're seeing for frequencies. So Mr. Pelly commented on our low R square values for frequency, but it's the flat nature of this data that must be considered, so our frequency data is quite flat, we get a low R square.

MS. NEWMAN: Can we look to an example of how the frequency data is quite flat in this case?

MS. ELLIOTT: We will get to that, yeah.

MS. NEWMAN: Fair enough.

MS. ELLIOTT: So even FA in some cases has chosen to dismiss their curve with high R square values by overriding their results with judgement. We're going to discuss this later when we talk about the flat trend issue, the zero percent. So I'm going to summarize here. What we're trying to do is develop loss trend rates that are appropriate for the last five years of accident year data, 1997 to 2001, that are being used to derive the premium level. We see that the trend rates that we derive from our regression analysis produced fitted values that are closer to the actual losses. We saw that on page 15 of the Mercer Report. And we acknowledge that our regression models produce lower R square than FA's model, however, we saw that the R square value and the T test statistics can be misleading, so I would suggest we don't need to be overly concerned about the R square. We're consistent in our approach year to year, our starting point is ten years, but as we see changes in the pattern of frequency, that's the number of accidents, number of claims per number of vehicles insured, we see a change there and we've been using five years for the physical damage frequency regression analysis. We don't try to change the number of years of data we use each year to get a higher, high R square. I showed you on page 14 of the Mercer Report the various number of years that are used by FA for different coverages, how they go back 18 years to 1984. We don't try to change the number of years that we use to get a higher R square, we want to be responsive to the current data and consistent in our approach.

MS. NEWMAN: So you had said that you use five years for the physical damage frequency?

MS. ELLIOTT: Yes, that's correct.

MS. NEWMAN: And what was the reason for that as compared to the ten years?

MS. ELLIOTT: We find that in the last five years compared to the prior five years, we find that when we look back in time, the frequency has been declining, but we see that this rate of decline is decreasing, so the last five years, 1997 to 2001, is different from the period of 1996 and prior, so we feel that going back so far in time is not reflective of what's happening today to frequency within the last five years, and, remember, we are trying to project forward the 1997 to 2001 data for the pricing analysis here. And, you know, I want to bring everyone to a page in the exhibit though. I've been repeating this fact that if 1997 ... let me show you why. We can go to Tab 7.

MS. NEWMAN: Are we in the application?

MS. ELLIOTT: In the application, page 7.1.

MS. NEWMAN: Appendix A?

MS. ELLIOTT: Appendix A, (inaudible) example.

MS. NEWMAN: Page 7.1?

MS. ELLIOTT: I'm sorry, 7.2. I apologize. So this page here, prepared by Facility Association, is for third party liability and it's the derivation of the projected provincial loss costs for Newfoundland private passenger.

MS. NEWMAN: What does that mean?

MS. ELLIOTT: Well, this is where they're trying to project out. They use loss development factors, we've been discussing those, and they use loss trend factors, projection factors, to project the 1997 to 2001 data to what they believe the cost level that would be in effect for the proposed program that they want to implement in 2003. So here, for example, for 1997, they show the number of exposures, that's the number of cars ...

MS. NEWMAN: That's earned exposure?

MS. ELLIOTT: That were earned in that year, 10,000. They show the actual reported losses, 6.2 million. They show the development factor. This is the loss development factor, how much more they have to, they expect the cost to be. They include a provision for unallocated loss adjustment expenses, unallocated loss

adjustment expenses for those costs for settling claims from the claims department, and this derives what they call their ultimate loss cost.

MS. NEWMAN: So what they've done here, if I understand you correctly, is they've taken the 6.2 million and multiplied it by the two factors, which is a development factor and the ULAE, is that correct ...

MS. ELLIOTT: That's correct.

MS. NEWMAN: ... to come up with the ultimate loss cost?

MS. ELLIOTT: And then they divide it by the number of earned exposures to get the ultimate loss cost.

MS. NEWMAN: 668 98 (phonetic).

MS. ELLIOTT: That's right. And the next step is to adjust this, is to measure what is the difference between the FA experience and the industry experience, and the matrix below, the top matrix is Facility data, the bottom matrix is industry data, so they want to look at the relationship between FA and industry. If we move along here, they show the number of reported claims.

MS. NEWMAN: The relationship between FA and industry, what does that show?

MS. ELLIOTT: Well, this shows that on average, based on the data that's provided on this sheet, on average the FA ultimate loss cost is 80 percent higher than the industry ultimate loss cost, and they use that, they take that factor that they've calculated and they look, how much credibility do I have with my data, and they credibility weight it. If it's not fully credible, they go to last year's factor and combine it to get a new factor, and in this case their new factor for this year is 80.15, so ...

MS. NEWMAN: And that's below there under risk factor?

MS. ELLIOTT: You'll see that below. And that adjusts the industry's data to the risk level that they believe to be comparable with an FA portfolio.

MS. NEWMAN: So that's the factor they would apply if they have to revert to industry data for any analysis, is that ...

MS. ELLIOTT: Right. They would take that, this adjust (phonetic) development loss cost, and if their old data, if FA's data is not considered credible by their standards, then they would apply some reliance upon this industry data that they have to adjust. So we end up with the last five years are the ultimate loss costs. We go along, reported number of claims, there's a CNTS, that's a claim count. They again ...

MS. NEWMAN: And what would that be?

MS. ELLIOTT: That's the number of claims that have been reported. There's a development factor applied to get the ultimate number of counts, and then the projection factor, this is essentially the loss trend factor, and we multiply the ultimate loss cost by the projection factor and that gives us this projected LC, the projected loss cost.

MS. NEWMAN: Okay. And where does this projection factor come from?

MS. ELLIOTT: This is derived from the loss trend regression analysis that FA has prepared. And so here we have 1997, a projected loss cost of $1,037, and we have 2001, the last five years, the most recent years, $1,625, and that experience of the last five years is weighted for an average of 1,418, so when we're talking about the last five years of data that ... that's what's important here for projection. These are the five years that we're referring to.

MS. NEWMAN: Mr. Chairman, it is 1:30 and I understand that counsel has a previous engagement. We would be looking to move on to a new area that might take some time if we ... I don't know if we want to break this technical stuff up.

MR. SAUNDERS, PRESIDING CHAIRMAN: It might be a good idea. I think, Mr. O'Flaherty, you said you had a, had something else on.

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

MR. SAUNDERS, PRESIDING CHAIRMAN: So we'll break and come back in the morning at nine. Thank you, Ms. Elliott.

(adjourned to December 19, 2002)