Newfoundland & Labrador

BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

IN THE MATTER OF THE

2005 AUTOMOBILE INSURANCE BENCHMARK RATES

DECISION AND ORDER OF THE BOARD

ORDER No. A.I. 1 (2005)

BEFORE:

Mr. Robert Noseworthy
Chair and Chief Executive Officer

Ms. Darlene Whalen, P.Eng.
Vice-Chair

A.I. 1 (2005)

IN THE MATTER OF the *Automobile Insurance Act* (the *"Act"*);

AND IN THE MATTER OF a review by the Board of Commissioners of Public Utilities (the "*Board*") in relation to the setting of the 2005 benchmark rates and the benchmarking process currently used by the Board in regulating automobile insurance rates in Newfoundland and Labrador.

BEFORE:

Robert Noseworthy
Chair and Chief Executive Officer

Darlene Whalen, P.Eng.
Vice-Chair

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1.0 BACKGROUND

1.1 Legislative Authority and Regulatory Framework

The Board is the regulatory authority for, amongst other things, the approval of rates charged by insurers for the provision of automobile insurance in the Province. The Board is constituted pursuant to the *Public Utilities Act* (the P.U. Act), which provides the Board with primary regulatory responsibility over the electrical industry in the Province. In 1977, the Board, under the *Automobile Insurance Act* (the A.I. Act), was given authority to regulate rates charged for all classes of automobile insurance.

The Board's specific powers and responsibilities with respect to automobile insurance rates are set out in the *A.I. Act*. Section 49(1) requires insurers to file annually with the Board the rates proposed to be charged for automobile insurance. Section 49(2) provides that the Board may approve, prohibit or vary the rates. Section 50 prohibits an insurer from charging rates that have not been approved by the Board and Section 53 provides that rates are deemed approved if the Board does not approve, prohibit or vary the rates filed within 60 days from the filing of the rates.

The Department of Government Services, through the Insurance and Pensions Division, also has a legislated responsibility in relation to the insurance industry in general. The Office of the Superintendent of Insurance licenses insurance companies to transact various types of business in the Province. Representatives, agents, brokers, adjusters and adjustment companies are licensed. The Superintendent of Insurance is also responsible for market conduct issues, complaints and inquiries from consumers, solvency issues for local companies and reviewing trust accounts for agents and brokers.

1.2 Automobile Insurance Overview

In this Province automobile insurance is provided by approximately 55 companies, with some 15 companies writing in excess of 90% of all business. Of these, a number are under common ownership or form part of a group of related insurers, resulting in nine insurers writing in excess of 90% of all automobile insurance business in the Province. In 2003 the total amount of direct automobile insurance premiums written (DPW) in the Province was just under $274,000,000.

1.3 Benchmarking System

The Board regulates automobile insurance rates using a benchmarking system for all companies with the exception of Facility Association (FA). The benchmarks established by the Board are based on the overall industry reported loss experience in the Province by coverage and territory adjusted to reflect anticipated loss experience to be realized by the industry in the near future, all other things remaining constant. The result of this analysis is a single rate for each territory and coverage, referred to as the benchmark rate. This rate represents, and is often referred to, as the benchmark mid-point. With few exceptions the Board has undertaken an independent comprehensive benchmark analysis each year since 1977.

The main purposes of the benchmarking system are:

1. To expedite the review of rate filings by providing a streamlined approval process whereby automatic approval is given rate filings where the adjusted base rages and the differentials fall within the benchmark rate ranges.
2. To foster knowledgeable competition among the companies by providing a range of base rates which are the result of an actuarial analysis of the industry wide claims experience in the Province of Newfoundland and Labrador.
3. To ensure that rates charged policyholders are reflective of industry loss experience and that insurers are receiving premiums commensurate with the risks underwritten and which will meet their future claims obligations and recover their operating expenses.

In order to recognize the competitive nature of the insurance industry as well as the fact that certain companies may have operating practices, characteristics or a book of business that may distinguish them from the industry average, a band on the mid-point, which varies by coverage, is allowed. These bands are referred to as the upper and lower limits, or the maximum and minimum, of the benchmarks.

Companies filing adjusted base rates falling within the benchmark limits are subjected to a thorough review by the Board and, if the rates filed are found to conform in all respects to the benchmarks, the filing is approved by the Board without further actuarial review. Filings not conforming to the benchmarks are generally required to be actuarially justified, based on the insurer's own experience in the Province. These filings are subjected to an extensive review including a review by an independent actuarial consultant.

1.4 Legislative Reforms

On August 1, 2004 Government introduced reforms to the automobile insurance product and regulation of the industry in the Province. The main reforms centred around mandated rate reductions for Third Party Liability coverage of 9%, arising from the introduction of reform measures including the introduction of a $2,500 deductible on pain and suffering payments, moving wage settlements from a gross to net basis, and reducing settlements by amounts received from other collateral sources. At the same time Government mandated rate reductions in rates for all other coverages. The reform measures also place restrictions on the grounds an insurer could use to refuse to provide or to terminate insurance coverage. Insurers were also required to file additional information with the Board, including their underwriting guidelines and the risk classification system used to rate risks. The responsibilities of the Board in respect to regulation of the automobile insurance industry has been expanded through the introduction of these measures.

In September 2004 the Board revised its private passenger benchmarks to reflect these legislated reductions.

1.5 2005 Actuarial Benchmark Report

The Board's actuarial consultants Mercer Oliver Wyman Actuarial Consulting Limited ("Mercer") prepared a report "Proposed Newfoundland and Labrador Private Passenger and Commercial Automobile Insurance Benchmark Ranges for 2005", (the "Mercer report") dated October 12, 2004. This report proposes benchmark rate ranges for automobile insurance rate filings taking effect during the period between January 1, 2005 and December 31, 2005. Table 1 shows the average percentage changes recommended by Mercer to the current benchmark rates implemented by the Board in September 2004, by coverage and territory, for private passenger automobile for both CLEAR and MSRP[1].

TABLE 1
Recommended Average Change in 2005 Benchmark Rates
Private Passenger Automobile

Coverage	Territory 1	Territory 2	Territory 3	Private Passenger
Third Party Liability	-0.8%	-9.5%	-11.8%	-4.0%
Accident Benefits	-8.3%	-12.7%	-12.7%	-10.2%
Collision (CLEAR)	-11.5%	-15.3%	-12.3%	-13.1%
Collision (MSRP)	-10.6%	-18.4%	-11.4%	-13.9%
Comprehensive (CLEAR)	-20.7%	-20.7%	-20.7%	-20.7%
Comprehensive (MSRP)	-22.0%	-22.0%	-22.0%	-22.0%
Specified Perils (CLEAR)	-18.9%	-18.9%	-11.4%	-18.7%
Specified Perils (MSRP)	-19.9%	-19.9%	-19.9%	-19.9%
Uninsured Automobile	-15.0%	-15.0%	15.0%	-15.0%
Total (CLEAR)	**-4.4%**	**-11.7%**	**-13.0%**	**-7.3%**
Total (MSRP)	**-4.4%**	**-12.4%**	**-12.9%**	**-7.5%**

(Source: Mercer report, pg. 14)

[1] MSRP (Manufacturer's Suggested Retail Price) and CLEAR (Canadian Loss Experience Automobile Rating) refer to the systems used by the insurance industry to assign risks, and hence rating groups, to vehicles. See Section 7.0 of this Decision.

In its report Mercer (pg. 48) outlined the factors contributing to the indicated overall 7.3% reduction in rate level for private passenger automobile:

- The insurance industry results have improved in the Province in 2002 and 2003.

- Since 2001 the physical damage premium increases has been larger than it has been prior in 2001. These additional premium amounts, combined with favourable loss experience, are the main drivers of the recommended decreases for the physical damage coverages.

- The accident benefits benchmark base rate, a single rate for all territories, had been in effect throughout the 2001-2003 policy period; however, rate level decreases were indicated but were subject to the 15% cap. The current base rates implemented during 2004, varying by territory for accident benefits, has been subject to the 15% cap. The base rate proposed in this study for accident benefits for territory 2 and 3 continue to be subject to the 15% cap.

- The estimated annual loss trend factors have decreased this year over last year's selections, manly due to the improvement in loss experience for the last two years.

- The estimated loss development factors for third party liability (TPL) have decreased over last year's assumptions. These selections are in response to the emerging experience, and not as a result of changes in the basis for selecting the loss development factors.

- The unallocated loss adjustment expense (ULAE) factor has been on a general decline over the 1998 to 2003 period.

- The return on investment income rate (ROI) assumption (i.e., 5-year average of Government of Canada 10-year bonds) has continued to decline, and this combined with the Board's return on equity (ROE) target formula, (i.e., 2.5 points plus the ROI) has led to a decline in the profit provision included in the base rates.

Table 2 presents Mercer's recommended average percentage changes to the current benchmark rates, by coverage, for commercial automobile.

TABLE 2
Recommended Average Change in
2005 Benchmark Rates
Commercial Automobile

Coverage	Commercial Automobile
Third Party Liability	23.5%
Accident Benefits	32.3%
Collision	-13.9%
Comprehensive	-14.4%
Specified Perils	-18.8%
Uninsured Automobile	-4.5%
Total	**19.0%**

(Source: Mercer report, pg. 15)

The overall rate level change for commercial automobile benchmarks of 19% is mainly affected by the TPL rate level change indication, since it is the largest coverage by premium volume.

Tables 3 and 4 show the recommended 2005 benchmark base rate ranges for private passenger and commercial automobile, for rate filings taking effect during the period between January 1,2005 and December 31, 2005, using the existing benchmark ranges by coverage as set by the Board.

Table 3
Private Passenger Automobile
Proposed 2005 Benchmark Base Rate Ranges

Coverage	Territory 1	Territory 2	Territory 3
Third Party Liability	$640 - 782	$336 - 411	$237 – 321
Collision			
MSRP	145 - 177	137 - 168	162 - 220
CLEAR	123 - 151	117 - 143	138 – 187
Comprehensive			
MSRP	67 – 82	53 – 65	64 – 87
CLEAR	71 – 87	57 – 70	60 – 82
Specified Perils			
MSRP	21 – 31	11 – 16	11 – 16
CLEAR	19 – 29	10 – 16	11 – 16
Accident Benefits	47 – 110	38 – 90	38 – 90
Uninsured Automobile	19 - 45	8 – 18	6 - 14

(Source: Mercer report, Appendix A, Exhibit 1, pg. 1)

TABLE 4
Commercial Automobile
Proposed 2005 Benchmark Base Rate Ranges

Coverage	Entire Province
Third Party Liability	$649 – 793
Accident Benefits	155 - 189
Collision	99 - 120
Comprehensive	38 - 57
Specified Perils	21 - 48
Uninsured Automobile	5 - 12

(Source: Mercer report, Appendix B, Exhibit 1, pg. 1)

2.0 THE HEARING

2.1 Notice

On September 25, 2004 the Board published notice of a pre-hearing conference to be held on October 4, 2004 for the purpose of identifying intervenors and addressing procedural issues associated with the public hearing to be held into the setting of the 2005 benchmark rates and the benchmarking process currently used by the Board in regulating automobile insurance rates in the Province. The Rules of Procedure and a Schedule of Dates were established at the pre-hearing conference. The public hearing was scheduled to begin on October 26, 2004.

2.2 Intervenors and Letters of Comment

The registered intervenors to the public hearing were:

i. Insurance Bureau of Canada (IBC), represented by Norman Whalen, Q.C.
ii. Government appointed Consumer Advocate, Thomas Johnson, LL.B.

These registered intervenors participated fully in the hearing by presenting evidence, cross-examination, calling expert witnesses, and filing final written submissions.

In addition the following companies indicated that they wished to participate in the public hearing in a limited manner:

i. Unifund Assurance Company, represented by Donald Sword, Corporate Counsel and Secretary
ii. Metro General Insurance Corporation Ltd., represented by Kevin Hutchings, President and Secretary Treasurer
iii. Insurance Corporation of Newfoundland, represented by Dave Anthony, President and CEO
iv. Aviva, Scottish and York, Traders General, Elite and S&Y Insurance Company, represented by Bernard Stevenson
v. Dominion of Canada General Insurance Company, represented by Brigid Murphy
vi. Insurance Brokers Association of Newfoundland, represented by Darrell Swain

These limited intervenors did not file evidence or call witnesses during the hearing. Unifund, Insurance Corporation of Newfoundland and Metro General attended the hearing for most sitting days and participated in limited cross-examination of some witnesses.

The Board also received Letters of Comment from Victoria Harnum of the consumer's group Advocates for Fair Automobile Insurance, and from Katie Suljak, FCIA, FCAS, Vice President Actuarial Services, Co-operators General Insurance Company.

2.3 Public Hearing and Final Submissions

The public hearing was held over the period October 26 to November 16, 2004, for a total of 10 sitting days. The Board was assisted at the hearing by Mr. Mark Kennedy, LL.B., who acted as Board Hearing Counsel; Ms. Cheryl Blundon, Board Secretary; and Ms. Barbara Thistle, Assistant Board Secretary. The following witnesses were called by the parties and the Board:

<u>Witnesses appearing on behalf of the Board:</u>

Ms. Paula L. Elliot, F.C.A.S., F.C.I.A., Mercer Oliver Wyman Actuarial Consulting Limited, Toronto, ON
Dr. Cindy W. Ma, Ph.D., CPA, CFA, Vice-President, National Economic Research Associates, Inc. (NERA), New York, New York

<u>Witnesses appearing on behalf of IBC:</u>

Mr. Ronald R. Miller, F.C.A.S., F.C.I.A., Exactor Insurance Services Inc., Toronto, ON
Ms. Kathleen C. McShane, C.F.A., Senior Vice President, Foster Associates Inc., Bethesda, Maryland
Dr. Norma Nielson, Ph.D., Chairholder in Insurance and Risk Management, Haskayne School of Business, University of Calgary, Calgary, AB
Mr. Henning Norup, Consultant to the IBC, Toronto, ON
Mr. Gary Kapac, Vice-President, Data Quality Management, IBC, Toronto, ON
Mr. Nathaniel S. Shapo, Partner, Sonnenschein, Chicago, Illinois
Mr. Donald Forgeron, Atlantic Vice-President, IBC, Halifax, NS
Ms. Jane Voll, Vice-President, Policy Development, Chief Economist, IBC

<u>Witnesses appearing on behalf of the Consumer Advocate:</u>

Mr. Christopher Tait, F.C.A.S., M.A.A.A., Milliman, Inc., Wayne, Pennsylvania
Dr. Basil Kalymon, Professor of Finance, Richard Ivey School of Business, University of Western Ontario
Ms. Edwina Walsh, Senior Policy Analyst, Policy and Planning Division, Department of Transportation and Works, Government of Newfoundland and Labrador
Ms. Kimberly A. Harding, Director, Information Services, Royal Newfoundland Constabulary
Ms. Lenora Taylor, Supervisor of Driver Records, Department of Motor Vehicles, Government of Newfoundland and Labrador
Ms. Barbara Reid, Insurance Consultant, Regional Office of Human Resources and Skills Development Canada for Newfoundland and Labrador

Final written submissions were filed by IBC, the Consumer Advocate, and Unifund on November 29, 2004, and by Board Hearing Counsel on November 30, 2004.

In addition to the sworn evidence given at the hearing, additional evidence was entered through information, consents and exhibits filed during the hearing, and through undertakings by the parties. The Board has considered all the evidence before it in this proceeding, and will refer directly to the evidence upon which it based its findings as set out in this Decision.

3.0 ACTUARIAL EVIDENCE AND ANALYSIS

3.1 Actuarial Issues Raised

The IBC and the Consumer Advocate filed actuarial evidence with respect to Mercer's actuarial report and its assumptions and findings. Both the IBC's actuary, Mr. Miller of Exactor Insurance Services Inc., and the Consumer Advocate's actuary, Mr. Tait of Milliman, Inc., agreed that the approach and methodology used by Mercer in its 2005 benchmark report was reasonable and in accordance with accepted actuarial practice. However both raised concerns with respect to certain issues and assumptions of Mercer and provided alternate assumptions for the Board's consideration.

The specific issues raised included:

i) Mercer's approach to adjust for Facility Association experience;
ii) premium to equity ratio assumptions;
iii) claim payment pattern; and
iv) incorporation of savings from Bill 30 reforms.

The combined effect of IBC's alternate actuarial assumptions would result in the overall indicated rate for private passenger TPL increasing by an average 21.5%, compared to Mercer's indicated average decrease of 4.3%. Most of these issues were also identified to be relevant to commercial automobile benchmarks.

The Consumer Advocate's actuary did not raise any issues with respect to Mercer's overall methodology and generally did not disagree with Mercer's approach or with many of the key assumptions. Milliman did highlight certain areas however where a different approach is recommended. Milliman's noteworthy differences were with respect to Mercer's:

(i) imputing no legislative reform savings for commercial insurance generally;
(ii) using a higher loss trend for commercial auto (8.0% vs 6.6%);
(iii) using the prescribed tax rate of 4.0% (vs 3.6%) in connection with the expense ratios;
(iv) using a higher operating expense ratio (7.5% vs 6.0%);
(v) using a different assumption with respect to payment pattern on actual losses;
(vi) using different weightings for the purposes of compensation for seasonality; and

(vii) using a commercial insurance coverage deductible differential incorporating a trend which may not be warranted based on recent experience.
(Post Hearing Submission, Consumer Advocate, pg. 28)

Milliman also commented on the actuarial issues raised by Exactor in their report. In addition to these specific issues the Consumer Advocate also submitted that there is an additional factor to be considered with respect to the effect of the collateral benefits reforms contained in Bill 30.

The evidence relating to the significant issues raised for both private passenger and commercial automobile is summarized below, along with the Board's findings with respect to each.

3.2 Private Passenger Benchmark Assumptions

3.2.1 Operating Expense Ratio Calculation

The operating expense ratio is comprised of expenses relating to commission and profits, licenses and fees, premium tax, and other operating expenses. Mercer calculated that the expense ratio for auto insurers operating in the Province is 25.5% of the direct premium written, composed of:

Commission and profits	13.5%
License and fees	0.5%
Premium Tax	4.0%
Other Operating Expenses	7.5%
Total Operating Expenses	**25.5%**

This estimate was based on data submitted to the IBC on a voluntary basis by companies in the Province representing 52% of the auto insurance market by premium value. (Mercer report, pg. 28; Appendix A, Exhibit 3, pg. 1) A comparison of automobile expense ratios for the Province and countrywide was provided by Mercer as shown below:

Table 5
Automobile Insurance Expense Ratios

Year	Newfoundland	Countrywide	Difference
1997	29.5%	25.5%	4.0%
1998	28.1%	26.1%	2.0%
1999	28.9%	26.5%	2.4%
2000	28.0%	25.4%	2.6%
2001	24.8%	24.4%	0.4%
2002	25.1%	23.4%	1.7%
2003	25.1%	22.3%	2.8%
Average			**2.3%**

(Source: Mercer report, pg. 29, Table 12)

In its analysis Milliman raised the "commission and profit commissions" ratio from 13.5% as assumed by Mercer to 14.5% to reflect the higher recent historical ratios of 15.5% (2002) and 15.1% (2003).

Mercer selected a "premium tax" ratio of 4.0% based on the fact that this is the premium tax as set out in legislation. The Consumer Advocate pointed out that evidence shows that actual premium payouts have never reached 4.0%, ranging from a low of 3.4% in 2002 to a high of 3.7% in 1999 and 2000. In 2003 the premium tax payout was 3.6% of direct premiums written. The Consumer Advocate supported the use of a rate of 3.6%, which is equivalent to the actual premium tax payout for 2003, and is recommended by Milliman. (Post Hearing Submissions, Consumer Advocate, pg. 50, para. 142) While acknowledging that 4.0% is the legislated premium tax in the Province, Milliman submitted that it is reasonable to base the projected tax on what companies have historically paid.

The Consumer Advocate also submitted that the assumption by Mercer of 7.5% for the other operating expense ratio is too high, since it puts too much weight on the earlier years when other operating expense ratios were significantly higher. In 1998 this ratio was 13.9% and steadily declined to 5.6% in 2002. Milliman used a figure of 6.0% in its analysis to reflect the declines in more recent years, and the Consumer Advocate recommended this approach.

The alternate assumptions used by Milliman result in a total operating expense ratio of 24.6% versus 25.5% used in the Mercer report.

Mr. Miller did not raise any issues with respect to the operating expense ratio assumed by Mercer.

On cross-examination Ms. Elliott of Mercer stated that, since 4% is the legislated premium tax in this Province, this is the appropriate number to include in premiums being developed for the 2005 policy year. The difference in the numbers (between the 4% legislated tax and the actual tax paid) may, in Ms. Elliott's opinion, be due to timing issues, where there is a mismatch of the premium taxes paid related to the premium written in that year. No explanation was offered by the other actuaries.

The Board accepts the use of 4% for the premium tax in the expense ratio assumption by Mercer. Although the actual premium tax paid has been slightly lower in the years 1998 – 2004, the Board agrees with Mercer that, for prospective rate setting, the use of the legislated premium tax of 4%, is appropriate.

With respect to the issue of the alternate ratio selections for commission and profit-commissions, and the other operating expenses, Milliman has selected numbers that give more weighting to the recent years, compared to Mercer's assumptions. This results in a higher ratio for commission and profit-commissions (14.5% vs Mercer's 13.5%) and a lower ratio for other operating expenses (6.0% vs Mercer's 7.5%). The difference is a net decrease in total other operating expenses of 0.5% for these two components. On cross-examination Ms. Elliot acknowledged that Milliman's total operating expense was not significantly different from Mercer's assumption and was therefore not unreasonable. Ms. Elliot also pointed out that, while the commission and profit-commission ratio for the Province has been increasing, the other operating expense ratio has been decreasing. When compared to the countrywide data Ms. Elliott indicated that she had some reservations about the allocation between those expense ratios.

Table 3 compares selected expense ratios for Newfoundland and Labrador and countrywide.

Table 6
Comparison of Selected Expense Ratios
(% of Direct Premium Written)

	Commission & Profit-Commission			Other Operating Expenses		
	NL	**Countrywide**	**Difference**	**NL**	**Countrywide**	**Difference**
1998	10.0	11.4	1.4	13.9	11.1	2.8
1999	13.4	11.7	1.7	11.2	11.2	9
2000	14.1	11.5	2.6	9.7	10.3	(0.6)
2001	13.9	11.6	2.3	7.0	9.4	(2.4)
2002	15.5	11.7	3.8	5.6	8.3	(2.7)
2003	15.1	11.5	3.6	5.9	7.2	(1.3)

(Source: Mercer report, Appendix A, Exhibit 3, pg. 1)

The Board notes that the commission and profit-commission as a percentage of direct premium written in the Province has increased since 1998 from 10.0% to 15.1% in 2003, with a high of 15.5%% in 2002, while the same ratio on a countrywide basis has remained fairly constant, within a range of 11.4% to 11.7%. The spread in the commission and profit-commission ratio in the Province and countrywide has increased from 1.4% in 1998 to 3.6% in 2003, with a high of 3.8% in 2002. While Ms. Elliot expressed some concerns about the allocation between the expense ratios for commission and profit-commissions in the provincial data, the Board notes that a similar decrease in the other operating expense ratio has also occurred in the countrywide data. However this expense ratio in the Province has gone from being higher than the countrywide data to lower than the countrywide data, decreasing from 13.9% in 1998 to 5.9% in 2003. Over the same period the countrywide other operating expense ratio decreased from 11.1% to 7.2%. This difference does suggest that there may be some other factors at play in the Newfoundland and Labrador market which is affecting these expense ratios differently.

The Board is satisfied that a total operating expense ratio of 25.0% is reasonable for the 2005 benchmark analysis. While Milliman has used different assumptions in arriving at its alternate assumption of 24.6% for the total operating expense ratio, the Board notes that acceptance of the 4.0% premium tax instead of 3.6% recommended by Milliman increases this ratio to 25.0%. As well, the Board notes that the average expense ratio for the period 2001-2003 has remained relatively stable in the range of 24.8% to 25.1%, with an average of 25.0%.

With respect to the reasons as to why the expense ratios in Newfoundland and Labrador have tracked higher than the countrywide average, the Board notes the comments of Mr. Forgeron of the IBC during cross-examination by the Consumer Advocate:

> *"We understand that in terms of that expense ratio here in Newfoundland, that one of the likely reasons why we're seeing a slightly higher number, and I say slightly because when taken in the context of an overall rate, is not—it's not a very significant number—the difference between the two. We've far more, what's known as managing general agents here in Newfoundland than we do in other parts of the country. So those brokers actually do far more than a standard—than a regular broker would do in terms of issuing—underwriting business, issuing the policies, settling the claims and so on and therefore they're compensated at a higher level than a traditional broker who simply, not simply, but whose responsibilities are far less."* (Transcript, Nov. 16, 2004, pg. 73/2-19)

The Board is interested in pursuing further the reasons for the significant differences in certain components of the operating expense ratio data in the Province compared to countrywide data. The Board also notes the comments of the Consumer Advocate with respect to the expense ratio information and the fact that only 52% of insurers in this Province (by premium volume) voluntarily report these figures to the IBC. The Consumer Advocate suggested that this may be contributing to an inaccurate picture of the combined ratio. The Consumer Advocate supports the disclosure of all expense ratio components by member insurers to the IBC. (Post Hearing Submissions, Consumer Advocate, pg. 51, para. 145) The Board will undertake further review of this issue in conjunction with its benchmark review for 2006. This review will include requesting additional information from insurers if deemed necessary by the Board.

The Board finds that an expense ratio of 25.0% for the Total Operating Expense Ratio is reasonable for use in the 2005 benchmark analysis.

3.2.2 Adjustment to Remove Facility Association Experience

The loss cost per exposure data provided to the actuaries includes data for the entire industry together with a breakdown for Facility Association (FA). Since the benchmark rates are intended for the regular market Mercer removes the FA unadjusted reported incurred loss and unallocated loss adjustment expense data and earned vehicle count data from the industry actual loss ratio experience. (Appendix A, Exhibit 2, pg. 1) The adjustment to remove FA data involves subtracting the applicable FA data from the industry data for each year (1999-2003) to arrive at a "Regular Market" value for each parameter. This adjustment is done prior to calculating the projected loss cost per exposure for each year and the weighted average projected average loss cost to be used in calculating the indicated benchmark rates for each territory.

Mr. Miller submitted that Mercer's approach is problematic since it assumes that the all-industry selected loss development trend and other factors are equally applicable to both FA and to the aggregate voluntary market. According to Mr. Miller the approach used by Mercer results in a mechanical projection of the adjustment to remove FA for the prospective rating period resulting from Mercer's selected accident year weights. Mr. Miller believes instead that the FA adjustment factor should be estimated in a non-mechanical way to try to reflect the expected size of FA for the prospective rating period, and should be applied at the end of the loss cost projection process, rather than at the beginning as Mercer does.

This alternate approach to adjust for FA experience is justified, according to Mr. Miller, on the basis that the restrictions imposed by the new regulations with respect to the grounds on which insurers may decline to issue, terminate, or refuse to renew contracts should be expected to lead to a significant reduction in the market share (by earned exposure) of FA. Analysis of the change in market share of FA over the period 1999-2003 leads Mr. Miller to estimate an FA market share for the prospective rating period of about 5% and a ratio of FA ultimate loss cost per car to all-industry of about 210%. This implies an FA adjustment rating factor of –5.9% compared to Mercer's –8.1%. Mr. Miller also suggested that it is entirely possible that the adjustment to remove FA should properly vary by territory but the data was not available to support such an analysis. (Pre-filed Evidence, Exactor Insurance Services Inc., pgs. 2-3)

Co-operators also suggested in its Letter of Comment that the implementation of legislation in August 1, 2004 will result in a shift in business from FA in to the regular market which will increase expected loss costs for the 2005 benchmarking period. Excluding FA experience totally will, according to Co-operators, result in benchmark rates that are too low for the expected exposures written by the regular market in the coming year.

The Consumer Advocate did not support Mr. Miller's approach, and stated that this approach was essentially an attempt to work backwards from a set of figures to obtain a result. Due to the inherent volatile nature of FA, a fact conceded by Mr. Miller, the Consumer Advocate submitted that any estimation as to FA experience is also subject to volatility. The Consumer Advocate also highlighted the selective nature of Mr. Miller's approach in minimizing the trend experience for the 2002 and 2003 years for the purpose of adjusting for FA data and then utilizing this experience for other purposes. The Consumer Advocate submitted that Mr. Miller's evidence on this point be disregarded altogether or be given relatively minimal weight. (Post Hearing Submissions, Consumer Advocate, pgs. 55-56)

Millman stated that the data in the Mercer report shows that the FA market share has increased fairly consistently from 1999 to 2003. In its report Milliman discussed the impact of general market conditions on the percentage of the market being written by FA. For example, when insurers feel their rates are adequate, or when they are earning strong investment returns, they are more likely to accept marginal drivers that would otherwise be assigned to FA. Mr. Tait explained this further in direct testimony stating that, in his opinion, the marginal risks (or grey market risks) are the risks that are moving between the voluntary market and FA, depending on insurers response to market conditions. Voluntary loss costs have improved over the period 1991-2003 partly because a greater percentage of marginal drivers, who would have been in the voluntary market, are being assigned to FA. Thus the historical loss costs from the older years in the experience period may overstate the projected losses for 2005 because the percentage of marginal drivers in the voluntary market has declined. Mr. Tait suggested that reduced weight could be assigned to the years 1999, 2000 and 2001 to adjust for a higher market share in FA in 2003. While not making any explicit assumption about what the FA market share would be going forward, Mr. Tait suggests that there is "an implicit assumption that it would stay relatively level to where it was in 2003." (Transcript, Oct. 28, 2004, pg. 82/14 to pg. 84/23)

The Board is not persuaded that there is any reason to reject Mercer's approach in adjusting for the FA experience to arrive at estimates for the regular market loss costs per exposure in each accident year for the regular market. No party argued that this adjustment was not necessary for the purpose of determining benchmark rates. The issue appears to be primarily with projecting the FA market share for the 2005 benchmarking period. On this issue the actuaries have divergent opinions. The Board notes that the FA market share in terms of earned exposure has varied considerably from 1999 to 2001, ranging from a low of approximately 3.5% in 2001 to a high of 7.1% in 2003. The increase in FA market share in terms of earned exposure along with a decrease in the loss costs for the regular or voluntary market does support Mr. Tait's suggestion that more insureds who are marginal risks are being placed in FA. The removal of these marginal risks from the regular market would be expected to result in a decrease in anticipated loss costs for the regular market.

The question then is whether the FA market share for the 2005 policy year will be in the range of 5% as suggested by Mr. Miller or 7% as suggested by Mr. Tait. The Board agrees with Mr. Miller that the restrictions put in place by legislation, in particular s. 96(1), should result in a reduction in the number of insureds being placed in FA. However the Board has no evidence before it to be able to actually quantify what the reduction might be. As well, since the legislation was proclaimed with effect from August 1, 2004, the full implementation of the new requirements will take place over the subsequent 12 month period. The Board notes that Mercer's approach results in a calculated market share for 2005 of 5.6%, which appears to be in the range of reasonableness based on the evidence of the actuaries.

The Board accepts Mercer's methodology for adjusting the industry data for FA experience for use in the 2005 benchmark analysis.

3.2.3 Premium to Equity Ratio

In order to generate benchmark rates appropriate for the aggregate voluntary market Mercer has assumed a uniform 225% premium to equity ratio for all coverages. This assumption was based on the midpoint of the range of premium to equity ratios typically used by insurers of 150% to 300%. The Consumer Advocate did not take issue with Mercer's approach or assumption for the premium to equity ratio used in the 2005 benchmark analysis.

Mr. Miller submitted that the assumption of a uniform premium to equity ratio for all coverages is not the best approach. According to Mr. Miller most observers agree that a lower premium to equity ratio is appropriate for those coverages with slower payout period, such as TPL, than for shorter tail coverages, such as Collision and Comprehensive. In Mr. Miller's opinion it is best practice to use different premium to equity ratios for different coverages. To arrive at an estimate of an appropriate premium to equity ratio Mr. Miller referred to the coverage specific premium to equity ratios recommended by Dr. Kalymon in the 1988 hearing before the Ontario Automobile Insurance Board (Liability: 124%; Personal Accident: 145%; Other: 314%). Based on these ratios Mr. Miller estimated a premium to equity ratio for TPL coverage for the prospective rating period of 124%, instead of the 225% used in the Mercer report. (Pre-Filed Evidence, Exactor Insurance Services Inc., pg. 7)

In pre-filed testimony (pg. 6), in reference to a question about the use in the Exactor report of the premium to equity ratios used in his 1988 Ontario testimony, Dr. Kalymon stated that he had not made any studies which would confirm the current validity of such ratios. According to Dr. Kalymon these ratios were developed in the context of the hearings with respect to automobile insurance firms in Ontario and within a margin pricing model which varies from that of the current model used in the Mercer report. Reliance on these ratios without specific confirmation of current conditions and consistency of classifications is problematic.

The Board agrees that reliance on the ratios used in a 1988 hearing without analysis and confirmation that these ratios would be applicable in current conditions for the industry is not appropriate. Mr. Miller suggested that, based on his actuarial judgement, a variation in the premium to equity ratio by coverage was most appropriate and was "best practice". However Mr. Miller did acknowledge that the method used by Mercer was "accepted practice" although it would, in his opinion, result in some coverages subsidizing other coverages. In the absence of a better substantiated alternate ratio, the Board is not persuaded there should be any adjustment in the premium to equity ratio as used by Mercer in the 2005 benchmark analysis.

The Board accepts Mercer's assumption of a uniform 225% premium to equity ratio for all coverages to be used in the 2005 benchmark analysis.

3.2.4 Claim Payment Pattern

The projected loss payment patterns are based on historical ratios of paid losses to estimated ultimate losses for TPL and Accident Benefits. These projected claim payment patterns are used in the underwriting profit margin calculations to estimate how much additional income insurers can anticipate from the investment of their loss reserves. Mercer truncated the TPL payment pattern at 132 months. Milliman suggested that this time period is too short and, as an alternate assumption, selected a TPL payment pattern over 144 months. For Accident Benefits Milliman selected a slightly slower projected payment pattern beyond 72 months of maturity, to give consideration to the patterns from accident years 1993 to 1996. The Consumer Advocate recommended the use of Milliman's approach.

Mr. Miller did not raise any issues with respect to the claim payment pattern assumed by Mercer.

The Board is not persuaded that Mercer's approach to determining the projected claim pattern should be rejected in favour of the alternate approach proposed by Milliman. Mercer's estimate is based on actuarial judgement, as is Milliman's, and the Board is satisfied that Mercer's approach is reasonable. Mercer's approach is also consistent with that taken in recent benchmark analyses and the Board notes that the use of the alternate claim payment patterns for TPL and Accident Benefits as suggested by Milliman has a minimal impact on the benchmark rates.

The Board accepts Mercer's assumptions with respect to claim payment patterns to be used in the 2005 benchmark analysis.

3.2.5 Incorporation of Savings from Bill 30 Reforms

Mercer estimates the total savings from Bill 30 reforms as 7.4% in 2005. This is based on an estimated saving of 4.7% as a result of the $2,500 non-pecuniary damages deductible, and a saving of 2.7% based on the provision for compensation of wage loss at 100% of net rather than 100% of gross wages. The Mercer report attributed no savings allowance for the statutory offset of past and future collateral source payments. The 7.4% savings are reflected in the proposed 2005 benchmark rates.

Both the IBC's and Consumer Advocate's actuaries commented on Mercer's approach with respect to the potential impact of Bill 30 reforms on the 2005 automobile insurance benchmarks.

In his evidence Mr. Miller noted that the $2,500 deductible is relatively small compared the average claim size and therefore is unlikely to realize its full theoretical effect. Mr. Miller stated that he expects that there would be an erosion of 80% of the anticipated saving, which would lower Mercer's estimate of 4.7% savings to 1.1%.

With respect to the reforms related to compensation of wage loss at 100% of net rather than 100% of gross, Mr. Miller agreed that there would be a potential for savings from this reform initiative. However he had serious reservations about whether the savings can actually be achieved. His expectation is that the courts will award income tax gross-up for this claim component as has been the practice, for example, with gross-up for income tax for future care awards in past court decisions. Mr. Miller also noted that, based on previous closed claim study data, future wage loss and past wage loss compensation in TPL bodily injury claims were almost equal. Therefore, while the saving would apply to the past wage loss it would not apply to the future wage loss component. Mr. Miller estimated a theoretical saving of 2.8% for this reform measure and reduced it to 1.4% because of the anticipated gross up by the Courts on future wage loss claims. This compares to Mercer's expected saving of 2.7%. Mr. Miller placed a total value of the savings resulting from the Bill 30 reforms at 2.5%, compared to Mercer's estimate of 7.4%.

Milliman suggested that the erosion of the savings from the $2,500 non-pecuniary damages deductible, assumed by Mercer to be 10%, should be no more than 4.1%. The erosion in savings occurs because, in a positive loss trend environment, the total losses will increase by loss trend, while the deductible losses will increase by something less than loss (because the deductible losses are capped at $2,500). The erosion factor should be 0% if all losses are below the deductible and equal to the loss trend if all losses are above the deductible. According to Milliman, since Mercer estimated a private passenger TPL loss trend of 4.1%, the maximum erosion factor is 4.1% rather than 10%. (Pre-Filed Evidence, Milliman, Inc., pg. 8)

With respect to the collateral benefits reduction, the Consumer Advocate also submitted that it is not reasonable to assume, as Mercer did, that "in almost all instances that the savings in connection with this item should be expected to be zero". This assumes in effect that the new legislation will be interpreted so as not to change the existing law as regards collateral benefits. These assumptions in both the Exactor report and the Mercer report are, according to the Consumer Advocate, inherently conservative and unreasonable.

To support this assertion the Consumer Advocate provided evidence from Ms. Barbara Reid, an Insurance Consultant with the Federal office of Human Resources and Skills Development Canada (HRSDC) in the Province. Based on this evidence the Consumer Advocate submitted that there will be a legislative reduction factor with respect to EI Sick Leave such that there will be a "direct dollar-for-dollar reduction of past lost wage claim against the auto insurer to the extent that EI benefits have been received." According to the Consumer Advocate these savings should be reflected in the 2005 benchmark rates for both private passenger and commercial insurance and not treated as zero savings as in Mercer's and Exactor's reports. The Consumer Advocate stated:

> *"The emphasis in s. 26.5 of the Act is to relieve auto insurers from payments for wage loss in instances where they are not already exposed to subrogated claims by operation of law. Like s. 26.4 which converts the claimable wage loss from gross to net, it is intended to reduce the ultimate liability of the insurer."* (Post Hearing Submissions, Consumer Advocate, pg. 46, para 128)

The Board is not persuaded that Mercer's assumptions and approach to incorporating the expected savings from Bill 30 reforms relating to the impact of the $2,500 non-pecuniary damages deductible and the provision for compensation of wage loss based on net rather than gross wages into the 2005 benchmarks are unreasonable. All the actuaries agreed that there would be some savings resulting from these reform measures but there was disagreement on the level of the savings to be expected. In the Board's view this is an issue of actuarial judgement and the Board has not been presented with any evidence that would suggest that Mercer's estimates are unreasonable. The actual impact of the Bill 30 reforms may be affected by a number of issues, including behavioural factors of claimants, which are difficult to anticipate and quantify. The true impact on loss costs will not be known until there has been some experience in this jurisdiction.

The Board agrees however with the Consumer Advocate that there should be some savings reflected in the benchmarks arising from the Collateral Benefits reform measures in Bill 30. In cross-examination by Counsel for the IBC, Ms. Elliot stated that the reason for assuming 0% savings for collateral sources was that insurers would institute clauses for right of subrogation to offset this savings. Ms. Elliot confirmed however that other statutory benefits, such as EI or CPP, were not considered. (Transcript, Oct. 26, 2004, pgs. 141/13-25 to pg. 142/1-5)

However, while the Consumer Advocate submitted the savings are not zero, there was no evidence to suggest what the level of savings would be. In the March 2004 report of the Board to Government anticipated savings arising from collateral sources was measured and estimated to be 4.6%, based on the assumption that there would be no right of subrogation. This assumption was not reflected in the legislation which was passed. Based on the evidence with respect to EI sick leave benefits the Board estimates that the previously forecasted savings of 4.6% should be reduced by 75%.

The Board finds that a savings from collateral sources, estimated to be 1.1%, should be incorporated into the 2005 private passenger benchmarks.

3.3 Commercial Benchmark Assumptions

The Consumer Advocate stated that many of the remarks of Milliman with respect to the benchmarks for private passenger apply equally to commercial benchmark rates. The two specific areas of Mercer's report that Milliman commented specifically on were the average deductible differential and the loss cost trend selection for commercial auto.

With respect to the estimated average deductible rate differential, Milliman noted Mercer's selection of an average deductible differential of 0.9153, which is the historical 2003 differential. Mercer also selected an annual drift rate of –0.6%. Because the historical differentials do not exhibit a consistent upward or downward trend, Milliman believes it is reasonable to select an average differential of 0.9201 based on the historical differentials for 1999 through 2003 and annual drift rate of 0.0%.

Mercer has assumed a loss cost trend for commercial auto TPL of +8.0% which, according to Milliman, appears to be based on the assumption that the historical negative trend in claim frequency will not continue beyond 2003. Milliman stated that this is a reasonable but conservative assumption. Claim frequency cannot decline indefinitely but will possibly continue to decline at least through policy year 2005. Based on the estimated annual loss costs for accident years 1989 through 2003 Milliman estimated a trend rate for commercial auto TPL of +6.6%. The Consumer Advocate recommended this approach.

The Consumer Advocate also noted that the proposed benchmark rates for commercial coverages do not reflect any savings as a result of Bill 30, even though Bill 30 reforms apply to both commercial and private passenger coverages. Mercer stated the reason for this is the lack of available data to estimate the potential savings for the Bill 30 reforms for commercial loss costs. Milliman submitted that Mercer's approach of not reflecting any savings in commercial TPL rates as a result of Bill 30 is an unreasonably conservative approach. According to Milliman, regardless of the availability of data, Bill 30 will presumably result in some savings for commercial TPL. Milliman stated it would be reasonable, in the absence of data, to anticipate the same savings for commercial coverages as for private passenger coverages.

With respect to the assumptions by Mercer of the estimated average deductible differential and the loss cost trend for the commercial benchmark rates, the Board is not persuaded that Mercer's approach should be rejected in favour of the alternate approach proposed by Milliman. Mercer's estimates for both these components are based on actuarial judgement and, while another actuary may make alternate assumptions using the same data, the Board is satisfied that Mercer's approach is reasonable and consistent.

The Board agrees that the 2005 commercial benchmark rates should reflect some savings as a result of Bill 30. The Board notes Mercer's position that the reason no allowance for savings on loss costs for commercial automobile was included was due to unavailability of data. Mercer was able to estimate the savings for private passenger automobile loss costs due to Bill 30 because of the availability of closed claim data; however the same data was not available for commercial automobiles. The Board notes however that, since the completion of the 2005 benchmark report, a closed claim study has been undertaken for commercial automobile loss costs by Mercer. This study, along with others, forms part of the information the Board is reviewing as part of the automobile insurance review currently underway. The Board will request Mercer to incorporate the projected savings for commercial automobile TPL and uninsured automobile as a result of the introduction of the $2,500 deductible on bodily injury claims into the 2005 benchmark rates, to be consistent with the private passenger benchmark rate assumptions.

The Board finds that the 2005 benchmark rates for commercial automobile TPL and uninsured automobile should be revised to incorporate the anticipated savings from the introduction of a $2,500 deductible on bodily injury claims.

4.0 RETURN ON EQUITY

The Mercer report (pg. 12) defines total return on equity (ROE) as:

> *"…an insurer's profit as a percentage of its surplus, where profit is the sum of (a) underwriting profit, and (b) investment income earned on both the underwriting operations of the company and on the surplus carried by the company. The assumed target return on equity is based on the Board's selected methodology."*

The methodology currently used by the Board is to set the after-tax ROE to be equal to the return on investment (ROI) (before tax) plus 2.5%. As discussed in Section 5.0 the return on investment (ROI) is based on a (monthly) five-year average of the before-tax yields of ten-year Government of Canada bonds. The ROI used in developing the proposed 2005 benchmarks is 5.4%, resulting in an after-tax ROE assumption of 7.9%. (Mercer report, pg. 39)

All experts agreed that the 7.9% ROE assumed for the benchmark report is inadequate. However there was a wide range of opinion on what the appropriate ROE target should be for the purposes of establishing the benchmark rates.

The NERA report recommended a range of 11-14% for the cost of equity, based on an analysis using a combination of the Capital Asset Pricing Model (CAPM) and the Discounted Cash Flow (DCF) models. According to NERA combining both models would alleviate concerns regarding the inherent deficiencies in each of the models, with one model acting as check on the other. NERA applied these two models to two "proxy groups" comprising of selected companies with comparable market risks. NERA used a screening process to select companies for each proxy group in order to arrive at a sample of comparative companies that could be viewed as an adequate representation of the local market. The proxy groups are:

i) Proxy Group I focuses on insurers active in the US property and casualty ("P&C") market. This set is constructed from the 26 companies from the *Insurance (Property/Casualty) Industry* section of the Value Line Investment Survey.

ii) Proxy Group II focuses on insurers active in the Canadian auto market. This set of comparables, which is obtained from A.M. Best Corporation, relies on A.M. Best's ranking of the top one hundred Canadian Auto Writers in 2003. NERA stated that 12 of the top 25 underwriters operating in the province are represented in this sample.

Application of the DCF model to both proxy groups requires an estimate of dividend growth. This estimate was based on an average of forecasts of earnings per share as published by Value Line for the companies in the proxy group, and consensus analysts' forecasts of earnings, as summarized by I/B/E/S and published by Factset Research Systems. The DCF model indicated an average ROE of 14.38% for Proxy Group I and 13.64% for Proxy Group II.

The CAPM model was applied to the US based Proxy Group I by taking the current yield on long-term (20-year) U.S. government debt securities to be the risk free rate. The market risk premium was taken to be the long-horizon expected equity risk premium based on the differences of returns on the S&P 500 over "risk-free" bonds during the period 1926-2003. For consistency the beta calculation was also based on the S&P 500 index for the estimation period from October 2001 to October 2004, based on weekend closing stock prices for the proxy group. The CAPM approach resulted in an ROE for Proxy Group I of 11.37%.

For the Canadian based Proxy Group II NERA employed two approaches. The first approach estimated the cost of equity using data that are specific to the Canadian financial markets. The risk-free rate was taken as the yield on long-term Canada bonds to which was added a Canadian risk premium. This equity risk premium for each proxy company was equal to the beta, measured relative to the Toronto Stock Exchange ("TSE") composite index, times the long-horizon expected equity risk premium (defined as the long-term returns of the Canadian stock market in excess of the returns on Canadian government bonds.) The second approach is the same approach as taken for Proxy Group I using risk-free rates and market premium from the US financial markets. The CAPM model indicates an average ROE of 10.39% for Proxy Group II using Canadian financial data. The corresponding ROE using US financial data is 11.69%. NERA noted that the first approach, using Canadian financial data, appears to be most consistent with current regulatory practice in Canada.

NERA also examined the impact of leverage and the associated financial risk on the ROE, since investors in highly leveraged companies in a given sector will require higher rates of return than investors in less leveraged companies in the same sector. The majority of companies in both proxy groups have debt to capital ratios of over 80%, which indicates a high degree leverage as compared to the utilities sector. The average leverage of the subset of Proxy Group II companies that have subsidiaries operating in the province is 87%, while the average leverage of the remaining companies in Proxy Group II is 82%.

The IBC witness Ms. Nielson acknowledged that the NERA report was sound in its methodology and that the DCF and CAPM models were the most widely used financial methods in regulatory proceedings both in the insurance and public utilities industries. The evidence of Ms. Nielson and Mr. Bernier suggested refinements of the NERA conclusions, especially in light of recent academic developments. In particular Nielson and Bernier cited recent work in the U.S.[1] suggesting an alternate approach, called the full-information beta (FIB) approach, in order to identify the impact of various lines of business on the cost of capital of insurers. Nielson and Bernier stated that, according to the authors of this study, the FIB approach is an improvement upon the classical approach which involves identifying publicly traded firms that specialize in a given product or line of business (e.g. auto insurance), and then approximating this line's cost of capital as the average cost of capital for the non-diversified or "pure play" firms. The FIB approach uses a pricing model called the Fama-French three-factor (FF3F) model, which retains the CAPM risk-premium for systematic market risk but adds risk premia for two additional factors to capture the effects of firm size and financial distress. Nielson and Bernier suggested that this study shows that recognition of other sources of risk other than the market systematic risk found in the CAPM could lead to significant under-pricing in regulated lines above and beyond those recognized in CAPM. Based on this recent work Neilson and Bernier concluded that the cost of equity capital for auto insurers in Canada may be as high as 16%. However since this latest work has not been replicated with Canadian data, Neilson and Bernier suggested that a cost of equity capital in the range of 13% to 16% is more appropriate for the Board to use when setting benchmark automobile insurance rates. (Prepared testimony of Norma L. Nielson, Ph.D. and Gilles Bernier, Ph.D.; November 10, 2004; pgs. 5-8; 12)

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[1] Cummins, J. David and Richard D. Phillips. "Estimating the Cost of Equity Capital for Property-Liability Insurers." Forthcoming in Journal of Risk and Insurance. *(Not yet published but included as Appendix B to Neilson and Bernier's prepared testimony)*

While not providing an analysis of the specific ROE for automobile insurance companies in the province, Ms. McShane provided an analysis of the differences in risk and fair return between public utilities and auto insurers. These differences include monopoly vs. competition, complexity of industry and forecasting, cost recovery provisions, sensitivity to capital market volatility, stability of returns, and leverage. To account for the higher financial risks of automobile insurers as compared with public utilities, Ms. McShane suggested that the ROE for auto insurers should be at least 2.5% higher than that allowed for a utility, or 12.0%. Ms. McShane went further to suggest that the ROE for auto insurers in this province may be higher based on the fact that auto insurers in this province are more highly leveraged than average for the industry. Adding an additional factor for this higher business risk and some factor for political risk, Ms. McShane suggested that an ROE in the upper range of NERA's 11-14% appears reasonable.

The IBC's actuary, Mr. Miller, acknowledged that Mercer's assumption of 7.9% for ROE is based on the Board's policy, but concluded that an appropriate ROE would be 12.5%. This conclusion was based on NERA's report and on Dr. Kalymon's 1988 testimony on the cost of equity for automobile insurance firms in Ontario, which estimated a range of 12.5% to 13.5%.

In pre-filed evidence (pg. 3) Dr. Kalymon provided his opinion that NERA's recommendation of 11-14% for ROE substantially overstates the cost of equity capital to the automobile insurance firms operating in the province. Dr. Kalymon identified and discussed several issues in the NERA report which he disagreed with, specifically the use of analyst growth estimates in the DCF approach, the proxy group selection generally and the use of US based market risk premiums in the CAPM model, and the lack of market value adjusted comparable earnings tests.

Dr. Kalymon recommended a target ROE for setting automobile insurance rates of 9.0-10.0%. This recommendation was based on his assessment of the capital market environment as being essentially stable over the past year with long-term Government of Canada bond rates trading in a relatively narrow range. According to Dr. Kalymon, current 30-year Canada bond rates are at around 5.03% and 10-year Canada bond rates are at 4.05%. Given that the long-term market risk premium based on previous studies is at around 4.6% and that the beta risk of insurance operations is around 1.0, Dr. Kalymon stated that the cost of equity capital for setting automobile insurance rates should be 9.63% (5.03% + 4.6%). (Pre-filed Evidence, Dr. Kalymon, pg. 12)

The Consumer Advocate submitted that the role of the assumed ROE in the benchmark process must be kept in context. In final submission the Consumer Advocate stated the following:

> *"37. The Benchmarking process in this province should allow auto insurers an adequate target return on equity. That is in the insurers' interest and it is also in the consumers' interest.*
>
> *38. However, it must be borne in mind that assumed ROE, while a highly significant variable for benchmarking purposes, is not the sole focus of the exercise. The Consumer Advocate submits that the role of the assumed ROE must be kept in context. In particular, the assumption of ROE:*
>
> *i) does not prescribe an actual result for a particular company or companies in practice. Companies may underperform or overperform relative to assumed ROE in any given year based on a number of factors;*
>
> *ii) is an assumption relevant to benchmarking for auto line of business only. Significant evidence in this hearing was devoted to rate setting practices for utility companies, many of them American, for the purposes of comparison. The Consumer Advocate notes that the theoretical investor, in considering whether to invest in an insurance company, would invest in that company as a whole and not exclusively in one line of that company's business. Therefore, comparing a public utility rate award to an insurer's assumed auto line ROE is dangerously misleading, as the other (non-mandatory) lines of business carried on by particular company may realize profits significantly higher than either utilities or assumed auto-line ROE in any given year."* (Consumer Advocate, Post Hearing Submissions, pg. 14)

With respect to the expert evidence of the IBC on the issue of ROE, the Consumer Advocate submitted that the opinion of Dr. Nielson on the range of cost of equity capital should not be given any weight. As well the Consumer Advocate submitted that, since the evidence of Ms. McShane does not provide an opinion on what the appropriate cost of equity is for automobile insurers operating in the province, it provides little assistance to the Board in considering this issue for the purpose of the 2005 benchmarks. The Consumer Advocate also noted that recent statements by the IBC in other jurisdictions with respect to ROE establish that the IBC believe an ROE of 10% to 10.5% was necessary and reasonable to attract capital in 2002 when interest rates were higher than they are presently. (Consumer Advocate, Post Hearing Submissions, pg. 19, paras. 50-51)

In its Letter of Comment the Co-operators stated that the ROE assumed in the 2005 benchmark report is too low and that a minimum ROE assumption of 12% after tax should be used, consistent with returns that publicly traded financial institutions achieve.

In considering the issue of the appropriate ROE for automobile insurance benchmark rates in this Province, the Board found Dr. Kalymon's evidence and testimony most instructive and compelling. The Board's current methodology for ROE is based on the OAIB methodology arising from a 1988 hearing to review the cost of equity capital for automobile insurance firms in Ontario. As Dr. Kalymon indicated in his pre-filed evidence (pg. 16), the current conditions in the capital markets are vastly different from those pertaining in 1988. In particular there has been a drop of about 5.0% in long-term Canada bond yields. With this drop in bond yields Dr. Kalymon submitted it would be completely inconsistent to believe that investors in the equity of insurance firms have also not lowered their expected returns. The decline in bond yields would also be reflected in lower cost of equity capital as indicated by the CAPM or risk premium tests widely used by financial witnesses and regulatory boards in Canada. Indeed the returns granted utilities in Canada by regulatory boards in recent years reflect this relationship, with allowed returns ranging from 9.15% to 10.15%. The average 30-year Canada bond yield in these decisions was approximately 5.7% compared to the average corresponding allowed ROE of 9.5%. (Pre-filed Evidence, K. McShane, pg. 8) The Board also notes Dr. Kalymon's evidence that long-term studies of risk premiums indicate that the market risk premiums are currently higher than those which were applicable under the economic conditions of 1988. Financial theory suggests that, due to the impact of taxes, it is likely that the market risk premiums will rise as bond yields decline. (Transcript, Nov. 9, 2004, pgs. 45-46)

The Board is satisfied that the equity risk premium test (CAPM) used by NERA is an appropriate test which can be principally relied upon for estimating the average ROE for the 2005 benchmarks. The equity risk premium test has been relied upon by the Board in recent regulatory decisions. For example in its recent 2003 decision [Order No. P. U. 19(2003)] regarding Newfoundland Power Inc., the Province's only investor owned utility[1], the Board confirmed its decision to rely principally on the equity risk premium test for establishing the

[1] Newfoundland and Labrador Hydro is a Crown Corporation.

appropriate return on regulated common equity for Newfoundland Power. The Board stated as one of its reasons for this decision was that "the equity risk premium test is anchored in the bond market which has demonstrated significantly greater stability in recent years as compared to the equity market." Most Canadian regulators use the equity risk premium approach to set the allowed return on equity for public utilities.

In one of its options applying the CAPM approach NERA used a Canada-specific equity risk premium indicating it is the most consistent with current regulatory practice in Canada. (Pre-filed Evidence, NERA, pg. 13) While noting he short-cutted his normal review, Dr. Kalymon pointed out that NERA in using Canadian data comes extremely close to the number at the top of his range. (Transcript, Nov. 9, 2004, pgs. 41-42) Given the variety of methodologies and conclusions introduced into evidence by the cost of capital experts, the Board is persuaded by the CAPM approach and those data similarities of NERA and Dr. Kalymon, as follows:

	NERA	**Dr. Kalymon**
Long-Term Canadian Bond Yield	5.11%	5.03%
Beta	1.06	1.0
Equity Risk Premium	5.00%	4.6%
Using	TSE Ibbotson	Dimson Study
Resulting ROE	10.39%	9.63%

The Board notes the difference between the two regarding the approach to estimating the equity risk premium. NERA used *"Canadian Risk Premia over Time Report"* by Ibbotson Associates, 2004 whereas Dr. Kalymon applied the Dimson Study which he rated as the same quality of the Ibbotson data except it looks at international markets, including the U.S. Dr. Kalymon suggested that for Canada the 4.6% figure for the equity risk premium is actually lower. The Board notes that the Ibbotson equity risk premium is based on data using the TSE Index from 1936 through 2003. Furthermore, 12 of the top 25 Newfoundland and Labrador underwriters are represented in the Proxy Group II sample in NERA's CAPM calculation referenced above. The Board also notes that the capital structures of companies (subsidiaries) have similar capital structures to companies in Proxy Group II (87% debt-NL versus 82% debt-Canada) making additional adjustments for increased business risk unnecessary.

In summary, the Board concludes the results using CAPM model presented by NERA and Dr. Kalymon provide a reliable source of evidence in setting an appropriate ROE. This method has been used as a sound basis for regulatory decisions elsewhere in Canada and has been accepted by this Board in the past as a reasonable approach to determining ROE. The Board favours NERA's calculation of the equity risk premium because of its Canadian content and related connection to this jurisdiction. The Board is satisfied that an appropriate range for the cost of equity for automobile insurance firms in the Province is 9.63% - 10.39%. For the purposes of setting benchmark rates the Board will use an ROE of 10.0%, which is the midpoint of this range.

The Board finds that an ROE of 10.0% is reasonable for use in determining the 2005 benchmark rates for automobile insurance in Newfoundland and Labrador.

5.0 RETURN ON INVESTMENT

In considering return on investment (ROI), the Board notes the linkage between ROE and ROI referred to by the cost of capital experts. Dr. Kalymon pointed out that the measured risks of these companies is a blend of all activities, which is both insurance and investment. Dr. Kalymon observed the first order issue is how much return should be allowed on equity and then how much return on investment should be allowed to reflect the risk to the investors on the actual portfolio. (Transcript, Nov. 9, 2004, pgs. 123-125 & pg. 48) Ms. McShane agreed with Dr. Kalymon that there should be an internal consistency between the ROE and the value of the return on the average risk investment in the investment portfolio, but the ROI needs to reflect the actual portfolio. (Transcript, Nov. 10, 2004, pg. 64)

The Board's existing methodology used in the Mercer report links ROE and ROI directly. The methodology is to set the after-tax ROE to be equal to the ROI (before tax) plus 2.5%. The ROI is based on a monthly five-year average of the before-tax yields of ten-year Government of Canada Bonds. The ROI used in the proposed 2005 benchmark report is 5.4% with the after-tax ROE set, therefore, at 7.9%.

Dr. Kalymon submitted that the 5.4% used by Mercer, in accordance with the Board's methodology, fails to reflect the actual investment practices of Canadian automobile insurance firms. To support this opinion Dr. Kalymon stated that the level of risk measured by beta studies of proxy samples reflects the risks which insurers actually undertake and that, if all investments were limited to Government of Canada bonds, the risk profile of insurance companies would be lower than observed. It is not appropriate to set the ROE based on observed risk and at the same time set ROI on the basis of a very conservative portfolio. Such an assumed investment portfolio, according to Dr. Kalymon, does not reflect either the opportunity or the reality of insurance company investment practices.

Mr. Miller submitted that it was best practice to separate investment income into separate components. One rate of return would be identified as appropriate for investment income on equity reserves, comprising long-term investments, and a different rate of return be identified for investment income from underwriting operations derived from investments of a much shorter duration. According to Mr. Miller the pre-tax return on investment income from underwriting operations is impacted by the nature of the particular coverage. As an example, property damage claims are traditionally resolved very quickly resulting in a relatively short investment period for those funds. TPL bodily injury claims tend to have a longer run-out period and, in Mr. Miller's opinion, a three-year or slightly longer investment period would be appropriate for underwriting investment income for that particular coverage. Mr. Miller suggested that current three-year bond returns support 3.75% as a reasonable return on three-year investments. Mr. Miller recommended that pre-tax ROI be lowered for underwriting investment income.

The Board agrees with the evidence of Dr. Kalymon and Ms. McShane that ROI should reflect to the extent possible the actual investment practices of Canadian automobile insurers and should bear an internal consistency to ROE in the benchmarking process. The proposed use by Mr. Miller of three-year bond returns or the use by the Board of average 10-year Government bond yields essentially assumes all investment income is generated in risk-free bonds. This situation is not consistent with the evidence. As Dr. Kalymon stated: "*The industry investment portfolio can have various maturities, and durations within its investment portfolio, some portions of which would be recognizing the short-term duration of some of their obligations, and other portions which would recognize the much longer-tailed portions of their obligations.*" (Transcript, Nov. 9, 2004, pg.64) This is consistent with the evidence of Mr. Miller concerning the deployment of investment reserves to satisfy both short-term and long-term claim obligations.

Information #4 filed by the IBC shows the actual distribution by type of investable assets as of June 30, 2004 of federally registered P&C insurers in Canada. This shows that at that time approximately 79% of investments were held in term deposits and bonds and debentures, 5.4% was held in cash, with the remaining 15.6% held in other investment instruments such as mortgage loans, preferred and common shares, real estate, and other. On request by the Board the IBC provided a further breakdown of the term deposits and bonds and debentures as of December 31, 2003. (Undertaking # 13) This information indicated that approximately 68% of the term deposits and bonds and debentures was held in Government-grade bonds, with the remaining held in investment and non-investment grade instruments, mainly corporate securities.

The Board agrees that a benchmark methodology for setting ROI is based on levels of risk and commensurate returns relative to the actual investment profile of Canadian automobile insurers is most appropriate. The Board notes that this actual investment portfolio comprises both Government grade bonds and corporate securities. The Board is satisfied that this ROI methodology is best able to reflect the automobile insurers' actual investment portfolio and financial returns and is most conducive to the prospective nature of regulatory rate setting.

In accepting this methodology, the Board acknowledges there is little evidence pointing to a conclusive determination of ROI on this basis. While acknowledging this shortcoming, there was little consensus otherwise at the hearing concerning an appropriate ROI. The Board notes the wide range of ROI's presented into evidence from Mr. Miller's 3.75% based on three-year bond yields to Mercer's report using 10-year Canada yields of 5.4% to Dr. Kalymon's recommendation of 7.04%[1]. The Board agrees that Dr. Kalymon's evidence supporting a regulated average investment portfolio most closely aligns with the Board's preferred method of calculating ROI. In his pre-filed evidence (pg. 4) Dr. Kalymon stated:

> "*It is my assessment that the ROI value of 5.4% based on the average five year yield on Government of Canada Bonds is too low. This level of return does not reflect the full range of investment instruments which are available and generally used by insurance firms. The portfolio of investments by insurance firms can include corporate bonds, common shares, preferred shares, real estate and mortgages. Such investments offer a higher level of return to that of government bonds. Assuming that only 40% of investment portfolios are invested in market average risk investments at 9.5% would imply an average return on invested capital of 7.04%, significantly higher than the assumed 5.4%.*"

While the Board agrees with Dr. Kalymon's position respecting the need to reflect the expected actual investment portfolio in the determination of ROI, the Board notes Dr. Kalymon admits that the 40% figure was derived from a 'quick peek' at his '88 report. Dr. Kalymon indicated that due to time constraints, he was unable to apply his normal full review to the matter of ROI and only became aware during his testimony of the undertaking provided by IBC (U-IBC# 13) depicting the actual investment portfolio of the insurance industry.

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[1] Dr. Kalymon calculates the ROI as (5.4% x 0.60)+(9.5% x 0.40) = 7.04%, based on an assumed 60% of portfolio in bonds and 40% in other.

The range of ROI suggested by the experts was from 3.75% to 7.04%. The Board is satisfied that an ROI of more than 5.4% is justified given the investment portfolio reflected in U-IBC # 13 and the internal consistency suggested by the cost of capital experts between ROI and ROE. The Board notes the past commentary of Mr. Forgeron as set out in DF#1[1] at pg. 13, where he said "Insurers' return on investment has remained relatively stable over the past twenty-five years, remaining within a fairly narrow band of 7 to 11 percent."

Given that the Board is satisfied that the ROI should be above 5.4% and less than 7.04%, and in light of the suggestion that an ROI of 7% may be consistent with recent industry experience, the Board will use 7.0% as the investment return for purposes of the benchmark analysis for the 2005 benchmarking period. This figure is within the range recommended by the experts.

The Board believes that the determination of the appropriate ROI would have been considerably assisted with more detailed information regarding the financial performance of the industry. In light of the fact that the Superintendent of Insurance does not collect data in relation to ROI or ROE for the Newfoundland and Labrador automobile insurance market the Board will review the information that it collects through the Benchmark rate setting process with a view to ensuring that the best available information is placed on the record for a determination of these issues in future rate setting.

The Board finds that an ROI of 7.0% is reasonable for use in determining the 2005 benchmark rates for automobile insurance in Newfoundland and Labrador.

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[1] Evidence of the IBC before the Nova Scotia Utility and Review Board in the matter of Private Passenger Automobile Insurance Review, August 26, 2002

6.0 DATA REVIEW AND CREDIBILITY

Section 82.(1) of the *Newfoundland and Labrador Insurance Companies Act* sets out the statutory requirement to collect automobile statistical data from insurers:

> *"82.(1) A licensed insurer which carries on in the province the business of automobile insurance shall, where the superintendent so directs, prepare and file with the superintendent or with a statistical agency that the superintendent may designate, a record of its automobile insurance premiums and of its loss and expense costs in the province in a form and manner and according to the system of classification that the superintendent may prescribe."*

The Superintendent of Insurance for the Province has designated the IBC as the Statistical Agent for Newfoundland and Labrador. The IBC has the responsibility to collect, compile, ensure the quality and publish the automobile insurance experience results. All automobile insurers licensed in the province must report their automobile premium and claim experience to the IBC as the statistical agency in accordance with the Automobile Statistical Plan (ASP) manual prepared by the IBC. The IBC also performs the same role for Nova Scotia, Prince Edward Island, New Brunswick, Ontario, Alberta, and the three Territories.

The IBC releases six major automobile calendar/accident year AIX "Green Book" exhibits annually, summarizing data collected in each reporting jurisdiction for:

- Loss development (semi-annual)
- Actual loss ratio
- Territorial
- Classification
- Size of loss
- Driver/Vehicle classification

The development of the benchmark base rates and rating factors relies primarily upon these IBC industry data exhibits. According to Mercer the IBC AIX exhibits are the only source of the total industry automobile statistical data (i.e. all companies combined) suitable for ratemaking purposes. Mercer used the 2003 AIX Industry Exhibits, which include data valued as of December 31, 2003, in completing the 2005 benchmark report. The Mercer report stated that the data was not audited or verified by Mercer as it was the IBC's role to verify and review the data for reasonableness, accuracy and consistency.

Ms. Victoria Harnum raised the issue of data credibility in her written comments to the Board. Ms. Harnum's concerns were based on the fact that the data used to set benchmark rates for the insurance industry in the province was coming from the industry itself and that this was reason to question the data. The remedy proposed by Ms. Harnum is that the Board collect its own data.

The IBC pre-filed evidence outlining the IBC automobile data review process which was intended to clarify the process used by the IBC to review and verify the data provided by the industry to the IBC for preparing the AIX exhibits. Mr. Gary Kapac, Vice-President of Data Quality Management with the IBC, also testified at the hearing on this issue.

According to the evidence of Mr. Kapac, there are a series of monthly processes in place to ensure that the data reported is complete and correct. These steps include: i) a series of data quality manuals, web-based tools and reports to facilitate reporting; ii) a multi-level edit process of the submissions (initial edits, consistency and validity edits, and generation of error records for correction); and iii) submission review and analysis to check for data completeness and accuracy. In addition to the ongoing monthly processes above, a formal close-off process is conducted semi-annually prior to initiating the exhibit production process. Deficiency fees are imposed to act as an incentive to companies to submit timely, complete and accurate data.

The IBC also uses an Annual Balance Reconciliation (ABR) process to help ensure the completeness of statistical data reported by insurance companies. This balancing requires companies to reconcile their IBC data submissions for written premiums, paid and outstanding losses with their P&C-1 or P&C-2 Annual Statements filing to the office of the Ontario Superintendent of Financial Institutions (OSFI). A written sign-off is required by each company's Chief Financial Officer indicating that the total data submitted to the IBC is correct and reconciles with their financial statements.

Prior to publication the exhibits also undergo a rigorous review process, including detailed review by the IBC's actuarial department and a review by an external consulting actuary for data anomalies. In addition the Financial Services Commission of Ontario (FSCO), Ontario's insurance industry regulator, reviews in detail each Ontario industry exhibit, which may result in the IBC performing additional analysis. FSCO approval is also required prior to publication by the IBC of the industry exhibits.

The use of the IBC data for the benchmark analysis by the Board's actuary is appropriate and necessary. The Superintendent of Insurance has designated the IBC to act as the statistical agent for this province, not the Board. The IBC acts in a similar role for other provinces, under the supervision of the insurance regulators for those jurisdictions. The data is also used in these jurisdictions for developing and testing rates. The Board is not aware of any concerns or issues that would cause the Board to question the acceptability of the Exhibit data for the purposes of the benchmark analysis in this Province. The review process undertaken by the IBC to ensure data quality is comprehensive and rigorous and the Board is satisfied, based on Mr. Kapac's evidence and testimony, that there is no reason to question the credibility or validity of the data.

The Board accepts the use by its actuaries of the IBC data for the purposes of preparing the 2005 benchmark report.

7.0 VEHICLE RATE GROUP METHODOLOGY

The IBC filed evidence on the vehicle rate group methodology, which provided an overview of the system used by the insurance industry to assign risks to vehicles, recognizing that different makes and models of automobiles present different risks. Insurers have differentiated these risks in various manners, such as price of vehicle or type of vehicle. Prior to 1970 insurers rated the vehicle risks based on the original price of the vehicle or on the Manufacturer's Suggested Retail Price (MSRP). In the 1970s the MSRP system was amended to adjust vehicle rate groups which were based on price alone with the actual experience by different vehicle type, based on US experience.

In 1989 the Ontario Automobile Insurance Board (OAIB) held hearings into auto insurance, including the classification systems used by insurers in that Province. Following that proceeding, the Vehicle Information Center of Canada (VICC) was established to design and implement a Canadian experience-based vehicle rating system. This system is referred to as CLEAR (Canadian Loss Experience Automobile Rating), and is a system of categorizing Private Passenger vehicles based on actual vehicle claim experience, by make and model-year, for physical damage coverage rating purposes. CLEAR considers such elements as the repairability and damageability of the make and model-year. In 1994 both the Ontario Insurance Commission (successor organization to OAIB) and the Manitoba Public Insurance Corporation accepted the new CLEAR methodology. Since that time there has been a general move away from the MSRP system towards the CLEAR system by insurers in most jurisdictions in Canada.

The evidence of Mr. Henning Norup presented a comprehensive overview of the background and methodology associated with the vehicle rating system CLEAR and also the impact of implementing CLEAR on premiums as insurers move from MSRP to CLEAR. Mr. Norup stated that it was his understanding that the breakdown between the use of MSRP and CLEAR in Newfoundland and Labrador is approximately 50/50. (Transcript, Nov. 4, 2004, pg. 17/11-13) There are issues associated with switching to CLEAR, including the overall effect on the total premium that the company is writing and the dislocation on individual policies in terms of increases or decreases in premiums.

In its report (pgs. 25-26) Mercer discussed the impact of the use of CLEAR vs MSRP for rating vehicles on premiums. In general if an insurer uses the CLEAR system the base rate will be lower but the average vehicle rate group factor will be higher, compared to the MSRP system. Hypothetically the estimated total premium for all cars is the same, regardless of which rating system is used. However the CLEAR methodology is a more in-depth approach and it is generally accepted that the premium for a specific vehicle based on the CLEAR system more accurately reflects the future claims experience than the premium based on the MSRP system.

Recent changes to the MSRP and CLEAR methodology have been introduced in Newfoundland and Labrador, as well as other provinces in Canada, by the VICC which affect the rate group assignment systems, and physical damage coverage premiums. Prior to 2001 there was an automatic decline in the rate group assigned to a vehicle as it aged. In the current system, in general, most vehicles will now maintain their current rate group as they age. Therefore, since 2001, as new vehicles enter the market most are assigned a rate group higher than the previous corresponding model year's rate group and, generally, that rate group will not be changed throughout the life of the vehicle. Since older vehicles will, in general, maintain their originally assigned rate group, and new vehicles will be assigned to progressively higher rate groups, this new system generates increased physical damage coverage premiums. This increased premium revenue, referred to as premium drift, is considered in deriving the benchmark base rates. (Mercer report, pgs. 41-41)

The evidence on this issue provided by the IBC was helpful to the Board in understanding the MSRP and CLEAR rate group assignment systems and the changes introduced in 2001. The Board notes that no parties to the hearing raised any further issues or made submissions on this matter, including the approach taken by Mercer to account for the resulting premium drift from increased physical damage coverage premiums. In the Board's view no further review or comment on this issue is required at this time.

8.0 BENCHMARKING PROCESS

As part of the Notice of the Public Hearing of the Benchmark hearing the Board stated that it wished to consider input from interested parties as to the benchmarking process currently used in regulating automobile insurance rates in the Province. Submissions were made by a number of parties, including the Consumer Advocate, the IBC and several of the limited intervenors. None of the submissions advocated that the existing benchmark process should be abandoned but rather suggested opportunities for refinement and improvement of the benchmarking process itself. These suggestions included modifying the benchmark range, using more current data, having standard release dates for the benchmarks, and improving approval time. The IBC also provided evidence in relation to issues of competitiveness and the role of regulation.

These issues are discussed in the following sections.

8.1 Rate Regulation and Competitiveness

The IBC's witnesses Ms. Jane Voll and Mr. Don Forgeron provided an overview of the Canadian insurance industry's vision for regulatory reform in Canada, and in the Province. Referring to the IBC's "Restoring Balance to Insurance Regulation" project, the IBC discussed a number of themes and issues with respect to opportunities for potential change and improvement in the existing regulatory framework.

In terms of key regulatory developments the following key themes were identified by the IBC as emerging from recent international and domestic regulatory developments:

> *"1. The need for regulators to serve as stewards, proactively monitoring the health of the insurance system as a whole.*
> *2. The advancement of risk-based regulatory concepts to allow regulators to focus their scarce resources on areas of greater need.*
> *3. Recognition of the role of market forces and the limits of price regulation."*

The IBC also canvassed extensively the role of markets and the effects of price regulation on auto insurance premiums. Citing research results, the IBC suggested that rate regulation, while it may be politically attractive, has no impact on average premiums. It was also suggested that prior approval regulation can make insurance rates more volatile, perhaps as a result of delays in the rate approval process. The delays may be the result of the approval process itself or as a result of insurers delaying filing smaller, more frequent, rate increases in favour of larger increases that justify the costs of assembling the detailed actuarial filing requirements. Even in jurisdictions where a formal prior approval system is not in place, but where very detailed actuarially justified filings are required, the IBC suggested there was evidence of increased premium volatility due to the regulatory regime. The IBC submitted that, in light of this research and evidence, it may be timely for the Board and Government to reconsider the goals of rate regulation, and to decide, based on the policy objectives identified, whether or not rate regulation involving the submission of detailed actuarial findings is really the best way to achieve these policy objectives. The IBC recommended caution however surrounding any expansion of the practice of rate regulation and requirements for more detailed filings in the areas already subject to rate review.

In Canada the Canadian Council of Insurance Regulators (CCIR) has created a working group to research options for introducing risk-based regulation in Canada. This group is comprised primarily of Government regulators (and not rate review boards). A risk-based regulatory model is currently being piloted in Ontario to demonstrate how the new risk-based approach could be applied to the supervision of company practices pertaining to the delivery of Ontario Statutory Accident Benefits, with preliminary results expected in April 2005.

While acknowledging that the international and Canadian move towards integrated, risk-based supervision, is not immediately applicable to the Board's decisions about specific benchmark rates being proposed for auto insurance for 2005, the IBC submitted it is relevant over the longer term horizon. The IBC suggested that the Board's role could evolve and change to fulfill perhaps a somewhat different mandate and function in the overall system of stewardship and oversight.

Another IBC witness, Mr. Nathaniel Shapo, an American insurance lawyer and former Director of Insurance for the State of Illinois, provided evidence and testimony on the development of regulation in the United States and the negative effect of price regulation in today's business environment. Mr. Shapo's position was that competition, and not price controls, were the best way to control costs. He stated:

> *"Basic mainstream economic theory firmly holds that competition is a far more thorough and effective method of regulating costs than price controls. Price controls have failed repeatedly whenever they have been employed to promote affordability of a product. Government interference distorts supply and creates availability crises while doing nothing to lower prices. Insurance has not been immune to this law of economics. Rather, extensive experience in the states has demonstrated the folly of price controls and the benefits of competition."* (Pre-filed Testimony, N. Shapo, Nov. 15, 2004, pgs. 7-8)

Citing academic literature and examples in the United States, Mr. Shapo concluded:

> *"In insurance, as in all industries where competition is allowed to regulate price, sellers of products best benefit consumers when they can (a) charge the appropriate price for their product (b) in real time in response to market conditions. This has been the experience of Illinois regulators for thirty years, including during my four years as Director of Insurance.*
>
> *Government control of ratemaking delays and distorts this process, ironically harming the consumers it is supposed to protect. Government has a substantial positive role to play in regulating insurance—in aggressive regulation of solvency, forms, and market conduct. But that does not extend to regulating price, where the insurance marketplace is subject to the same economic forces and truths as the rest of the economy."* (Pre-filed Testimony, N. Shapo, Nov. 15, 2004, pg. 14)

Ms. Voll also spoke to the benefits of supporting competition in the insurance industry in this Province, and offered an analysis of the level of competitiveness of the automobile insurance market in the Province. She described an index called the Herfindahl/Hirshman Index, which is a quantitative measure of competitiveness used by competition regulators and academics in Canada and US. According to Ms. Voll application of the index to the Province's auto insurance market indicates that the market is currently not concentrated, implying competitiveness. However, Ms. Voll highlighted the fact that the departure of any of the top writers in the province from the market would result in the market becoming more concentrated, which would not be in the best interest of consumers.

With respect to the existing benchmark rating system, the IBC stated the following:

> *"As far as rate regulatory systems go, it has been argued that the best outcomes for insurers and consumers are achieved when rates are competitively determined (Harrington 2001; Appel 2004). That said, benchmark systems, depending on how they are structured, may not be a bad compromise. The benchmarking process is a far better form of rate regulation than methods used by regulators in some other jurisdictions, but it is not without it limitations.*
>
> *Benchmarking has resulted in produced adjustments to premiums which some argue have helped, to some extent, in maintaining a balance between premiums and claims costs trends. It has been suggested by some that the Newfoundland and Labrador benchmark system is the primary reason why significant automobile insurance reform has not occurred in this province. While the other three Atlantic provinces have recently instituted significant reforms.*
>
> *The lack of reform is likely due, in part, to the lack of "crisis", which can develop when rapidly increasing claims costs are experienced by insurers. The requirement that premiums be adjusted annually reduces the possibility that insurers will find themselves with significantly inadequate premiums – a situation that most often results in availability and affordability problems for consumers. It must be noted however, that this lack of reform has also meant consumers have not seen the benefits of significant premium reductions, as consumers in other provinces have enjoyed as a result of product reform."* (Pre-filed Evidence, IBC, pg. 10)

The Board is satisfied that its existing benchmark system is necessary and appropriate for regulating automobile insurance rates in the Province. This benchmarking process continues to be, in the Board's view, an efficient and cost-effective approach for the Board to discharge its mandate with respect to automobile insurance rate regulation.

8.2 Benchmark Ranges

A benchmark range above and below the benchmark rate or mid-point reflects the fact that certain companies may have operating practices, characteristics or a book of business that may distinguish them from the industry average. For example, most companies will have different claims experience, profit provisions and expense ratios compared to the assumptions used to determine the benchmark base rates. The benchmark ranges also reflect possible parameter variance in components such as premium drift, territory relativity, loss development, loss trend, and claim payment patterns. The actual percentage range above and below the benchmark rate varies by coverage and territory as shown below:

Existing Benchmark Ranges

Coverage	Private Passenger			Commercial
	Territory 1	Territory 2	Territory 3	
Third Party Liability	± 10%	± 10%	± 15%	± 10%
Collision	± 10%	± 10%	± 10%	± 10%
Comprehensive	± 10%	± 10%	± 15%	± 10%
Specified Perils	± 20%	± 20%	± 20%	± 20%
Accident Benefits	± 40%	± 40%	± 40%	± 40%
Uninsured Motorist	± 40%	± 40%	± 40%	± 40%

Several issues were raised with respect to the benchmark range and the options which the Board could consider, including expanding the range, eliminating the lower or minimum benchmark, and introducing caps on the overall rate level change permitted if the benchmark ranges are increased or dropped.

The Mercer report (pg. 17) discussed the impact of increasing or decreasing the upper and/or lower bounds of the existing benchmark range. Since under current Board policy insurers must provide an independently justified filing to support rate levels above or below the benchmark ranges, expanding the range may allow more insurers to use the benchmark rates and factors. This could lead to a faster implementation of rate level changes by insurers and possibly a wider range of rates for consumers to choose from at any one time. However a wider range may permit higher overall rate changes from year to year for an individual insurer. Conversely, decreasing the upper and/or lower bound of these ranges would most likely lead to more insurers preparing independent rate filings, and probably less choice for consumers at any one time.

The Consumer Advocate did not support any increase in the upper range of the benchmark, as stated in final submission (pg. 68, para. 201):

> *"The Consumer Advocate is emphatically opposed to increasing the upper bound. The Consumer Advocate believes that it is in the interests of consumers for the Board to continue to keep the present rule of "plus 10%" in place for all coverages and to insist on sound actuarial justification before permitting filings above the upper bound. If consumers are to pay more for their coverage than that which has been actuarially indicated by the Board's* <u>*independent*</u> *actuary and approved by the Board in establishing the maximum bound, then that result should only be permitted once the case has been made by the particular insurer. The Consumer Advocate does*

not believe that such a change should be made even on an interim basis for the purposes of study and review."

The IBC supported an expansion of the benchmark range. In final submission (pg. 30) the IBC stated:

"Reconsideration of the band around the benchmark would also be welcome. For most companies, one of the true advantages of benchmark filing is the time and cost saved when compared to a full filing. A wider band would permit a greater share of filings to proceed in an expedited manner and would be marginally more akin to competitive rates."

Mr. Shapo, another IBC witness, also supported expansion of the benchmark range from ±10% to ±15%. In responding to a question from the panel as to whether he was advocating no regulation of rates, Mr. Shapo responded:

"...I would not necessarily be advocating that you go overnight to an Illinois system. I think that if that's something you were considering, that that's probably something that you'd want to phase in just, you know, for the protection of the market, because just going from one thing to something far different overnight, it's not necessarily, it's not necessarily a healthy thing. But in the bottom line I'd urge you to consider, you know, the more competition, the better, and I think that 15 percent is a nice way to bridge that gap."

In a letter of comment the Co-operators stated that, if the benchmarking system is maintained, the range should be widened to allow the majority of standard market insurers to write at benchmark rates. According to the Co-operators a range that is too narrow results in more independent filings, contributing to delays in implementing rate changes and added costs for review of these filings.

In its final written submission Unifund stated that, if the Board considers expanding the current range of ±10% for the 2005 benchmarks, it should do so only in the context of its decision as regards the actual midpoint benchmark and the ROE. If the Board accepts a lower estimate for both the competitive market will be negatively affected and the expansion of the range is more critical than if the midpoint benchmark and ROE are higher. Unifund's position is that, as a competitive market participant, neither the minimum nor the maximum should be removed with respect to the 2005 benchmarks.

The Mercer report also suggested that removal of the lower band on the benchmarks could provide the same benefits as increasing the range in terms of rate approvals and consumer choice. However Mercer cautioned that a range without a lower bound could lead to predatory pricing and/or higher overall rate changes from year to year for an individual consumer. On questioning from the Chair on this issue, Ms. Elliot stated:

> *"A. Well, in terms of predatory pricing, one could consider that if an insurer wants to increase its market share and is willing to increase the market share at the expense of a low profit level relative to what its ideal target would be. So and that does occur, I have seen that, have seen filings where an insurer has stated that, you know, that at this time they are requesting a lower, or they're using a lower return on equity within their filing because they're attempting to grown their market share and that context is quite specific. And they would state that knowing that a later filing they would increase the return on equity target within a filing. So that does occur. It is not often, but it would occur that someone would want to have lower premiums for that reason.*
> *Q. So it does occur?*
> *A. It does occur, but not, as I say, it's not something that I have seen frequently, but, yeah."*
> (Transcript, Oct. 27, 2004, pgs. 29/11-25; 30/1-7)

The Mercer report suggested that the concerns of higher overall year to year rate changes for insureds could be addressed by placing restrictions on the annual rate changes of insurers.

Dr. Kalymon submitted that the regulation of minimum rate levels (through the setting of a lower band) for automobile insurance rates should be eliminated and the Board should set only maximum rates. According to Dr. Kalymon the imposition of minimum rates for automobile insurance rates is not required for consumer protection. The operations of automobile insurance firms are regulated by either Federal or Provincial authorities depending on the form of registration and territory of operations. The regulation of minimum rates becomes redundant from the perspective of insurance firm solvency and may be detrimental to consumers through the artificial support of higher rates.

In direct testimony, in response to a question regarding Dr. Kalymon's opinion that there be a maximum benchmark but no minimum benchmark, Dr. Shapo responded:

> *"A. I personally would not favour that. I think, again, as we discussed earlier, that the origins of rate regulation, which, you know, are fairly obsolete now, were as a solvency tool, but that if you're going to regulate rates, that that minimum requirement is just as important, if not more so, than the maximum requirement. I think that, you know, rate regulation as a means of ensuring*

affordability and accessibility is—in a market that would otherwise be a competitive marketplace, is you know, is not an effective technique, whereas for years there has been some effectiveness in terms of using a rate regulation as a way to ensure that minimum price and a way to help solvency. So, I think that to the extent that it's used, I think the minimum would probably be more important than the maximum." (Transcript, Nov. 15, 2004, pg. 59/4-22)

In final argument the Consumer Advocate argued for the retention of an upper limit on the benchmarks on the basis that it may avoid volatility since actuarial justification allows an opportunity to objectively review premium increases versus loss cost development. With respect to the lower bound the Consumer Advocate submitted that he would be in favour of eliminating the lower bound on all coverages except third party liability. The Consumer Advocate stated:

"In the case of the third party liability coverage, the Consumer Advocate would support allowing filings – 20% of bench. Those companies with efficient operations who are prepared to lower their rates should not be given a disincentive from so doing. Such a change should be allowed for at least a sufficient period of time for the Board to observe whether predatory pricing is an issue or not." (Post Hearing Submission, Consumer Advocate, pg. 68, para. 202)

Unifund, a nationally regulated insurer with its head office in the Province, submitted that the removal of the minimum benchmark in a small province like Newfoundland and Labrador creates a risk of marketplace disruption through predatory pricing that could disproportionately affect smaller and local insurers. Unifund recommended that, without specific direction from Government, the Board ought not to adopt any policy that may cause harm to the local industry.

With respect to the benchmark ranges the Board notes that the ranges recognize the fact that companies have different circumstances and operating characteristics which can be accommodated within a range around the industry average benchmark rate. The Board also acknowledges the comments of the Consumer Advocate with respect to the benefits of complete actuarial justification before permitting filings above the upper bound. The Board notes that most of the insurers writing the majority of auto insurance premiums in the Province have TPL rates that are currently near or above the upper range. Where companies have received approval for filings outside the range, these filings have been actuarially justified. The Board is satisfied that the existing upper range limit should be maintained.

The Board is not persuaded that elimination of the lower bound of the benchmark range is justified. There was no evidence presented during the hearing to suggest that the existence of the lower range has produced a detrimental effect on consumers or the industry. When balanced with expressed concerns related to predatory pricing on the existing marketplace, especially by new market entrants, and the potential impact on consumers, the Board is of the opinion that a lower bound should be maintained.

With respect to the Consumer Advocate's proposal that the lower bound for TPL rates be expanded to allow for filings –20% below benchmark, the Board finds this recommendation may offer an opportunity for increased flexibility to insurers and lower premiums for consumers. Expansion of the lower bound will provide the opportunity for companies to file rates that would, under the existing lower range, be below benchmark (and hence considered a non-benchmark filing), without having to provide a complete actuarial justification, with the associated expense and review process time. The Board will expand the lower bound for TPL, collision and comprehensive coverages (MSRP and CLEAR) for both private passenger and commercial automobile to 20% for all territories. The Board is satisfied that expansion of the lower bound to 20% is sufficient to mitigate concerns related to predatory pricing.

Under the circumstances of an expanded lower range for certain coverages, the Board is concerned that, during a period of increasing loss costs and upward pressure on rates, consumers may be subject to significant overall increases in premiums year over year as insurers move to increase rates within the benchmark range. This possibility of "rate shock", which some may argue insureds have experienced in recent years, is an issue for the Board. To address this issue the Board will introduce an additional restriction on rate changes within the benchmark system. Insurers will be permitted to file, without actuarial justification, for rate increases up to a maximum of 5% on these coverages in a 12 month period where the proposed rates are within the benchmark ranges. Rate increases in excess of 5%, or rate increases that will result in rates above the upper limit of the benchmarks, will require actuarial justification based on the insurer's experience in this Province and will be subject to an independent actuarial review.

8.3 Other Recommendations

The IBC made several additional recommendations, which it believes will improve the benchmark regulation process in this province. These included:

i) tying the benchmark process to the data release dates and developing a method where the data from the first half of the current year be used to set the benchmarks for the upcoming year;

ii) standardizing the benchmark release dates; and

iii) shortening the approval time for filings outside the benchmarks.

As discussed in Section 6.0 of this Decision the Board's actuaries rely on the IBC's industry data exhibits to develop the benchmark rates. Data for a calendar year is generally available to the actuaries by June of the following year. For example the current benchmarks are based on 2003 data, which was released to the actuaries in mid-2004. In direct testimony Mr. Don Forgeron advised that the IBC also produces a six-month data report in October or November, for the first six months of the current calendar year. It was suggested that this data could be used in developing benchmarks to ensure that the benchmarks reflect current market conditions. (Transcript, Nov. 16, 2004; pg. 35/12-21)

The existing benchmark process is in effect tied to the release dates of the IBC's data. The Board notes the IBC's offer to work with the Board on reviewing this matter and would welcome any opportunities that the IBC may offer to allow for more recent data to be reflected in its benchmark analysis.

On the issue of standardizing release dates, the IBC submitted that filing on the anniversary date of a prior filing allows companies to control issues such as dislocation and to coordinate the collection of data to use in the filing. Not knowing the release dates of the benchmarks in advance can result in insurers having to redo their entire filing if, for example, they submit just prior to the benchmark release data. This can result in additional costs and delays in responding to market conditions. (Final Submission, IBC, pg. 29) The Board agrees that standard release dates have merit and to the extent practical will allow for standard release dates to be incorporated in its benchmarking process.

The IBC also recommended that approvals for filings outside the benchmark be shortened. In direct testimony Mr. Forgeron suggested that there was no legislated time frame or waiting period prescribed for the approval process outside of a benchmark filing. As well, it was suggested that non-benchmark filings "can take in excess of the 90 days that it takes for a benchmark filing". According to Mr. Forgeron, if the advantage of the benchmark system is to increase cost effectiveness and timelines, then this benefit is lost with long approval times. (Transcript, Nov. 16, 2004; pg. 38/6-21)

In considering this issue the Board reviewed the approval times for both benchmark filings and non-benchmark filings for 2002 and 2003. This review indicated that the average processing time (in business days) from receipt of the rate application to Board approval for benchmark filings was 25 days in 2002, ranging from 2 days to 43 days. In 2003 the average processing time was 21 days, ranging from 7 days to 48 days. Increased processing times are often related to the material filed and whether additional information is required by the Board in reviewing the filing. The Board cannot reconcile the figure of 90 days as referenced by Mr. Forgeron, as its own records do not support such a figure. The Board is also satisfied that these average approval times for benchmark filings are reasonable.

With respect to non-benchmark filings the average processing time in 2002 from receipt of filing to final approval was 50 days, ranging from 19 days to 85 days. In 2003 this processing time was 35 days, ranging from 10 days to 74 days. Again, the higher processing times are generally related to additional information requirements by the Board and the Board's actuary as part of the review of the individual filing. The turn-around time of these applications may be improved in part by companies ensuring that all filings are complete and in conformance with the Board's filing guidelines. The Board acknowledges that this is an important issue to industry and will continue to ensure efficient turn around time for filings.

8.4 Effective Date/Implementation of 2005 Benchmarks

The IBC, through Mr. Miller, raised concerns about the appropriate time period of application of the 2005 benchmark rates. Mercer's report has been prepared based on the assumption that these rates will take effect January 1, 2005 and remain in effect to December 31, 2005. However, given that there is a rate freeze in place until March 17, 2005, the proposed benchmarks will have no application for the period January 1, 2005 to March 16, 2005.

Ms. Elliot acknowledged that the proposed benchmark rates would have to be adjusted if the rates are to take effect March 17, 2005.

In light of the expiration of the rate freeze on March 17, 2005 the Board requested Mercer to adjust the proposed benchmark rates for private passenger and commercial automobile to reflect a March 17, 2005 effective date. In addition to the change in effective date, these adjusted benchmarks incorporated the changes required as a result of the Board's findings with respect to the benchmark methodology and assumptions, as set out in Section 3.0 of this Decision.

Tables 7 and 8 show the 2005 benchmark rate ranges to be effective March 17, 2005 for private passenger and commercial automobile. These benchmark ranges reflect the Board's revised lower benchmark ranges as outlined in Section 8.2.

Table 7
Province of Newfoundland and Labrador
2005 Private Passenger Benchmark Base Rate Ranges

Coverage[1]	Territory 1	Territory 2	Territory 3
Third Party Liability	$ 542-745	$ 291-400	$ 223-321
Accident Benefits	46-108	38-90	38-90
Uninsured Motorist	19-45	8-18	6-14
Collision (MSRP)[2]	128-176	122-167	153-220
Comprehensive (MSRP)	60-83	47-65	60-86
Specified Perils (MSRP)	21-31	11-17	10-16
All Perils (MSRP)	175-241	158-218	200-288
Collision (CLEAR)[3]	110-151	104-143	130-186
Comprehensive (CLEAR)	63-87	50-69	57-82
Specified Perils (CLEAR)	19-29	10-16	11-17
All Perils (CLEAR)	159-219	143-197	174-251

Territory 1 - Avalon District, Statistical Plan Code 004
Consisting of the City of St. John's, including that part of the Island east of Highway 202, being a line between the communities of Old Shop and Chapel Arm in Trinity Bay to the North and between Long Harbour and Ship Harbour in Placentia Bay in the South.

Territory 2 – Remainder of the Province, Statistical Plan Code 005, 007
Consisting of those parts of the Island of Newfoundland, excluding the Avalon District.

Territory 3 – Labrador District, Statistical Plan Code 006
The entire area of Labrador.

Table 8
Province of Newfoundland and Labrador
2005 Commercial Benchmark Base Rate Ranges

Coverage[4]	Entire Province[5]
Third Party Liability	$ 577-793
Collision	136-187
Comprehensive	86-119
Specified Perils	38-56
All Perils	194-267
Accident Benefits	20-48
Uninsured Motorist	5-11

[1] **Third Party Liability** rates are based upon: Class 02, Driving Record 5, $200,000 Limit. **Collision** rates are based upon: Class 02, Driving Record 5, Rate Group 9, $250 Deductible. **Comprehensive** and **Specified Perils** rate are based upon: Rate Group 9, $50 Deductible. **All Perils** rates are based on the sum of the Collision and Comprehensive rates for the same rate group, adjusted to the $250 Deductible level.

[2] **MSRP –** Manufacturers Suggested Retail Price.

[3] **CLEAR** - Canadian Loss Experience Automobile Rating. These are different rating systems used by insurers too determine premiums for collision.

[4] Commercial Rates are based upon Premium Table 1: **Third Party Liability** rates are based upon: Class 36, Driving Record 3, $200,000 Limit. **Collision -** $250 Deductible, Rate Group 9. **Comprehensive** and **Specified Perils -** $50 Deductible, Rate Group 9. **All Perils** rates are based on the sum of the Collision and Comprehensive rates for the same rate group, adjusted to the $250 Deductible level.

[5] No territorial definitions for commercial benchmarks.

Tables 9 and 10 show the indicated percentage changes for the 2005 benchmarks for private passenger and commercial automobile.

Table 9
Average Change for Benchmark Rates in 2005
Private Passenger Automobile
(Compared to current Benchmark Rates)

Coverage	Territory 1	Territory 2	Territory 3	Private Passenger (All Territories)
Third Party Liability	-5.5%	-11.8%	-11.8%	-7.8%
Accident Benefits	-9.7%	-12.7%	-12.7%	-11.0%
Collision (CLEAR)	-11.6%	-15.5%	-12.4%	-13.3%
Collision (MSRP)	-10.8%	-18.5%	-11.6%	-14.0%
Comprehensive (CLEAR)	-20.7%	-20.7%	-20.7%	-20.7%
Comprehensive (MSRP)	-22.0%	-22.0%	-22.0%	-22.0%
Specified Perils (CLEAR)	-18.9%	-18.9%	-12.0%	-18.7%
Specified Perils (MSRP)	-19.9%	-19.9%	-19.9%	-19.9%
Uninsured Automobile	-15.0%	-15.0%	15.0%	-15.0%
Total (CLEAR)	**-7.9%**	**-13.3%**	**-13.0%**	**-9.9%**
Total (MSRP)	**-7.9%**	**-13.9%**	**-13.0%**	**-10.2%**

Table 10
Average Change for Benchmark Rates in 2005
Commercial Automobile
(Compared to current Benchmark Rates)

Coverage	Entire Province
Third Party Liability	23.5%
Accident Benefits	32.3%
Collision (MSRP)[1]	-14.8%
Comprehensive (MSRP)	-15.6%
Specified Perils (MSRP)	-18.8%
Uninsured Automobile	- 7.2%
Total	**18.8%**

[1] **CLEAR** – does not apply to commercial vehicles.

9.0 ORDER

IT IS THEREFORE ORDERED THAT:

The Board hereby establishes as set out below the 2005 automobile insurance benchmark base rate ranges and differentials, which will take effect on March 17, 2005.

Province of Newfoundland and Labrador
Board of Commissioners of Public Utilities
2005 Private Passenger Benchmark Base Rate Ranges

Coverage[1]	Territory 1	Territory 2	Territory 3
Third Party Liability	$ 542-745	$ 291-400	$ 223-321
Accident Benefits	46-108	38-90	38-90
Uninsured Motorist	19-45	8-18	6-14
Collision (MSRP)[2]	128-176	122-167	153-220
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Comprehensive (CLEAR)	63-87	50-69	57-82
Specified Perils (CLEAR)	19-29	10-16	11-17
All Perils (CLEAR)	159-219	143-197	174-251

Territory 1 - Avalon District, Statistical Plan Code 004
Consisting of the City of St. John's, including that part of the Island east of Highway 202, being a line between the communities of Old Shop and Chapel Arm in Trinity Bay to the North and between Long Harbour and Ship Harbour in Placentia Bay in the South.

Territory 2 – Remainder of the Province, Statistical Plan Code 005, 007
Consisting of those parts of the Island of Newfoundland, excluding the Avalon District.

Territory 3 – Labrador District, Statistical Plan Code 006
The entire area of Labrador.

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[1] **Third Party Liability** rates are based upon: Class 02, Driving Record 5, $200,000 Limit. **Collision** rates are based upon: Class 02, Driving Record 5, Rate Group 9, $250 Deductible. **Comprehensive** and **Specified Perils** rate are based upon: Rate Group 9, $50 Deductible. **All Perils** rates are based on the sum of the Collision and Comprehensive rates for the same rate group, adjusted to the $250 Deductible level.

[2] **MSRP** – Manufacturers Suggested Retail Price.

[3] **CLEAR** – Canadian Loss Experience Automobile Rating. These are different rating systems used by insurers too determine premiums for collision.

Private Passenger Differentials

Third Party Liability

Class	Territory 1 Benchmark Differential	Territory 2 & 3 Benchmark Differential	**Driving Record**	Territory 1 Benchmark Differential	Territory 2 & 3 Benchmark Differential	**Inclusive Limit**	All Territories Benchmark Differential
01	0.830	0.913	6	0.860	0.725	200,000	1.000
02	1.000	1.000	5	1.000	1.000	300,000	1.073
03	1.096	1.180	4	1.442	1.331	500,000	1.160
05	0.203	0.190	3	1.680	1.523	1,000,000	1.265
06	0.492	0.533	2	1.745	1.575	2,000,000	1.409
07	1.129	1.257	1	1.947	1.588	3,000,000	1.409
08	1.439	1.643	0	2.250	1.964	5,000,000	1.467
09	1.331	1.329					
10	2.486	2.854					
11	1.804	2.150					
12	1.616	1.899					
13	1.520	1.627					
18	1.324	1.384					
19	1.077	1.168					

Private Passenger Differentials

Collision

Class	Territory 1 Benchmark Differential	Territory 2 & 3 Benchmark Differential
01	0.919	0.860
02	1.000	1.000
03	1.212	1.269
05	0.237	0.276
06	0.507	0.523
07	1.402	1.277
08	1.811	2.079
09	1.572	1.679
10	3.158	3.509
11	2.417	2.864
12	2.097	2.108
13	1.768	2.136
18	1.613	1.610
19	1.395	1.389

Driving Record	Benchmark Differential	Benchmark Differential
6	0.767	0.786
5	1.000	1.000
4	1.175	1.199
3	1.239	1.300
2	1.273	1.460
1	1.522	1.583
0	1.569	1.726

Deductible	Benchmark Differential
25	1.061
50	1.054
100	1.040
200	1.013
250	1.000
300	0.987
500	0.936
750	0.878
1000	0.825
1500	0.691
2000	0.570
2500	0.473

MSRP Rating Group	Benchmark Differential
1	0.250
2	0.290
3	0.350
4	0.410
5	0.490
6	0.570
7	0.670
8	0.800
9	1.000
10	1.200
11	1.400
12	1.600
13	1.800
14	2.000
15	2.200
16	2.400
17	2.600
18	2.800
19	3.000
20	3.200
21	3.400
22	3.600
23	3.800
24	4.000
25	4.200
26	4.400
27	4.600
28	4.800
29	5.000

CLEAR Rating Group	Benchmark Differential	**CLEAR Rating Group**	Benchmark Differential
1	0.300	51	7.545
2	0.395	52	7.745
3	0.495	53	7.945
4	0.595	54	8.145
5	0.695	55	8.345
6	0.795	56	8.545
7	0.895	57	8.745
8	0.995	58	8.945
9	1.095	59	9.145
10	1.195	60	9.345
11	1.295	61	9.545
12	1.395	62	9.745
13	1.495	63	9.945
14	1.595	64	10.145
15	1.695	65	10.345
16	1.795	66	10.545
17	1.895	67	10.745
18	1.995	68	10.945
19	2.095	69	11.145
20	2.195	70	11.345
21	2.295	71	11.545
22	2.395	72	11.745
23	2.495	73	11.945
24	2.595	74	12.145
25	2.695	75	12.345
26	2.795	76	12.545
27	2.895	77	12.745
28	2.995	78	12.945
29	3.145	79	13.145
30	3.345	80	13.345
31	3.545	81	13.545
32	3.745	82	13.745
33	3.945	83	13.945
34	4.145	84	14.145
35	4.345	85	14.345
36	4.545	86	14.545
37	4.745	87	14.745
38	4.945	88	14.945
39	5.145	89	15.145
40	5.345	90	15.345
41	5.545	91	15.545
42	5.745	92	15.745
43	5.945	93	15.945
44	6.145	94	16.145
45	6.345	95	16.345
46	6.545	96	16.545
47	6.745	97	16.745
48	6.945	98	16.945
49	7.145	99	17.145
50	7.345		

Private Passenger Differentials

Comprehensive					
MSRP Rating Group	Benchmark Differential	**CLEAR Rating Group**	Benchmark Differential	**CLEAR Rating Group**	Benchmark Differential
1	0.250	1	0.300	51	7.545
2	0.290	2	0.395	52	7.745
3	0.350	3	0.495	53	7.945
4	0.410	4	0.595	54	8.145
5	0.490	5	0.695	55	8.345
6	0.570	6	0.795	56	8.545
7	0.670	7	0.895	57	8.745
8	0.800	8	0.995	58	8.945
9	1.000	9	1.095	59	9.145
10	1.200	10	1.195	60	9.345
11	1.400	11	1.295	61	9.545
12	1.600	12	1.395	62	9.745
13	1.800	13	1.495	63	9.945
14	2.000	14	1.595	64	10.145
15	2.200	15	1.695	65	10.345
16	2.400	16	1.795	66	10.545
17	2.600	17	1.895	67	10.745
18	2.800	18	1.995	68	10.945
19	3.000	19	2.095	69	11.145
20	3.200	20	2.195	70	11.345
21	3.400	21	2.295	71	11.545
22	3.600	22	2.395	72	11.745
23	3.800	23	2.495	73	11.945
24	4.000	24	2.595	74	12.145
25	4.200	25	2.695	75	12.345
26	4.400	26	2.795	76	12.545
27	4.600	27	2.895	77	12.745
28	4.800	28	2.995	78	12.945
29	5.000	29	3.145	79	13.145
		30	3.345	80	13.345
		31	3.545	81	13.545
		32	3.745	82	13.745
	Benchmark	33	3.945	83	13.945
Deductible	Differential	34	4.145	84	14.145
25	1.034	35	4.345	85	14.345
50	1.000	36	4.545	86	14.545
100	0.938	37	4.745	87	14.745
200	0.833	38	4.945	88	14.945
250	0.785	39	5.145	89	15.145
500	0.582	40	5.345	90	15.345
750	0.461	41	5.545	91	15.545
1000	0.389	42	5.745	92	15.745
1500	0.290	43	5.945	93	15.945
2000	0.222	44	6.145	94	16.145
2500	0.180	45	6.345	95	16.345
		46	6.545	96	16.545
		47	6.745	97	16.745
		48	6.945	98	16.945
		49	7.145	99	17.145
		50	7.345		

Private Passenger Differentials

Specified Perils

MSRP Rating Group	Benchmark Differential	**CLEAR Rating Group**	Benchmark Differential	**CLEAR Rating Group**	Benchmark Differential
1	0.250	1	0.300	51	7.545
2	0.290	2	0.395	52	7.745
3	0.350	3	0.495	53	7.945
4	0.410	4	0.595	54	8.145
5	0.490	5	0.695	55	8.345
6	0.570	6	0.795	56	8.545
7	0.670	7	0.895	57	8.745
8	0.800	8	0.995	58	8.945
9	1.000	9	1.095	59	9.145
10	1.200	10	1.195	60	9.345
11	1.400	11	1.295	61	9.545
12	1.600	12	1.395	62	9.745
13	1.800	13	1.495	63	9.945
14	2.000	14	1.595	64	10.145
15	2.200	15	1.695	65	10.345
16	2.400	16	1.795	66	10.545
17	2.600	17	1.895	67	10.745
18	2.800	18	1.995	68	10.945
19	3.000	19	2.095	69	11.145
20	3.200	20	2.195	70	11.345
21	3.400	21	2.295	71	11.545
22	3.600	22	2.395	72	11.745
23	3.800	23	2.495	73	11.945
24	4.000	24	2.595	74	12.145
25	4.200	25	2.695	75	12.345
26	4.400	26	2.795	76	12.545
27	4.600	27	2.895	77	12.745
28	4.800	28	2.995	78	12.945
29	5.000	29	3.145	79	13.145
		30	3.345	80	13.345
		31	3.545	81	13.545
		32	3.745	82	13.745
	Benchmark	33	3.945	83	13.945
Deductible	Differential	34	4.145	84	14.145
25	1.034	35	4.345	85	14.345
50	1.000	36	4.545	86	14.545
100	0.938	37	4.745	87	14.745
200	0.833	38	4.945	88	14.945
250	0.785	39	5.145	89	15.145
500	0.582	40	5.345	90	15.345
750	0.461	41	5.545	91	15.545
1000	0.389	42	5.745	92	15.745
1500	0.290	43	5.945	93	15.945
2000	0.222	44	6.145	94	16.145
2500	0.180	45	6.345	95	16.345
		46	6.545	96	16.545
		47	6.745	97	16.745
		48	6.945	98	16.945
		49	7.145	99	17.145
		50	7.345		

Province of Newfoundland and Labrador
Board of Commissioners of Public Utilities
2005 Commercial Benchmark Base Rate Ranges

Coverage[1]	Entire Province[2]
Third Party Liability	$ 577-793
Collision	136-187
Comprehensive	86-119
Specified Perils	38-56
All Perils	194-267
Accident Benefits	20-48
Uninsured Motorist	5-11

Commercial Auto Differentials
Third Party Liability

Class	Benchmark Differential	**Inclusive Limit**	Benchmark Differential	**Driving Record**	Benchmark Differential
33	0.419	200,000	1.000	3	1.000
34	0.222	300,000	1.073	2	1.281
35	0.950	500,000	1.160	1	1.487
36	1.000	1,000,000	1.265	0	1.784
43	1.501	2,000,000	1.410		
44	0.974	3,000,000	1.409		
45	1.421	5,000,000	1.467		
46	1.441				
47	1.821				
48	1.883				
54	0.494				
55	0.122				

[1] Commercial Rates are based upon Premium Table 1: **Third Party Liability** rates are based upon: Class 36, Driving Record 3, $200,000 Limit. **Collision -** $250 Deductible, Rate Group 9. **Comprehensive** and **Specified Perils -** $50 Deductible, Rate Group 9. **All Perils** rates are based on the sum of the Collision and Comprehensive rates for the same rate group, adjusted to the $250 Deductible level.

[2] No territorial definitions for commercial benchmarks.

Commercial Auto Differentials

Collision

Class	Benchmark Differential
33	0.893
34	0.903
35	0.880
36	1.000
43	0.948
44	1.001
45	0.953
46	1.343
47	2.188
48	0.988
54	1.963
55	0.535

Driving Record	Benchmark Differential
3	1.000
2	1.385
1	1.467
0	1.842

Deductible	Benchmark Differential
25	1.100
50	1.090
100	1.070
200	1.023
250	1.000
300	0.990
500	0.890
1000	0.740
1500	0.620
2000	0.530
2500	0.460

Collision		**Comprehensive**		**Specified Perils**	
Rating Group	Benchmark Differential	**Rating Group**	Benchmark Differential	**Rating Group**	Benchmark Differential
1	0.195	1	0.195	1	0.169
2	0.229	2	0.229	2	0.222
3	0.269	3	0.269	3	0.262
4	0.337	4	0.337	4	0.313
5	0.427	5	0.427	5	0.403
6	0.535	6	0.535	6	0.512
7	0.658	7	0.658	7	0.638
8	0.827	8	0.827	8	0.814
9	1.000	9	1.000	9	1.000
10	1.161	10	1.161	10	1.175
11	1.309	11	1.309	11	1.341
12	1.445	12	1.445	12	1.498
13	1.634	13	1.634	13	1.719
14	1.808	14	1.808	14	1.930
15	1.970	15	1.970	15	2.130
16	2.129	16	2.129	16	2.333
17	2.276	17	2.276	17	2.527
18	2.412	18	2.412	18	2.710
19	2.536	19	2.536	19	2.884
20	2.649	20	2.649	20	3.048
21	2.753	21	2.753	21	3.202
22	2.861	22	2.861	22	3.364
23	2.973	23	2.973	23	3.534
24	3.090	24	3.090	24	3.712
25	3.211	25	3.211	25	3.900
26	3.338	26	3.338	26	4.097

Comprehensive		**Specified Perils**	
Deductible	Benchmark Differential	**Deductible**	Benchmark Differential
25	1.070	25	1.070
50	1.000	50	1.000
100	0.880	100	0.880
200	0.741	200	0.741
250	0.680	250	0.680
500	0.520	500	0.520
1000	0.420	1000	0.420
1500	0.360	1500	0.360
2000	0.330	2000	0.330
2500	0.310	2500	0.310

Dated at St. John's, Newfoundland and Labrador this 11th day of March 2005.

Robert Noseworthy,
Chair and Chief Executive Officer.

Darlene Whalen, P.Eng.,
Vice-Chair.

G. Cheryl Blundon,
Board Secretary.

Newfoundland & Labrador
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