

Responses to Questions Submitted by Public Utilities Board

1. a): While we didn't include these expenses in estimating "underwriting profits" in our T. 7, nevertheless, they are included in the calculation of pre-tax profits. We were interested in presenting the differences between premiums and claims in the row we labelled "underwriting profits". We do add that footnote 5 should refer to the data on p. 29 of the GISA Report, not p. 25.

b): We did not incorporate "Other revenues and expenses". The amounts were quite small (unavailable entirely for 2012), and their exclusion actually reduced the pre-tax income for the years 2014-2016 and the resulting ROEs.

2. a): We believe they should be the same; namely, the net investment income (interest, dividends and capital gains) as a percentage of the funds invested. We assumed that the equity allocated to auto insurance operations in Newfoundland and Labrador approximated the funds invested by the insurance companies. We were surprised by the significant differences. It appears in retrospect that the investment income data used by Oliver Wyman only included interest and dividends received and not any capital gains.

The two concepts asked about

1 $(\text{Allocated investment income to PAI})/(\text{Allocated equity to PAI})$, and

2 $(\text{Total investment income})/(\text{Total invested assets value})$

are indeed the same when assets value = total equity and the allocation to PAI is done based on say (PAI premiums) (Total Premiums) = W_{pai} . This is true since under these conditions

$(\text{Total investment income})/(\text{Total invested assets value}) =$

$(W_{\text{pai}} * \text{Total investment income}) / (W_{\text{pai}} * \text{Total invested assets value}) =$

$(\text{Allocated investment income to PAI}) / (\text{Allocated equity to PAI})$

b): As noted, we assumed invested assets and equity to be the same. We made this assumption for two reasons. We did not have any data for reserves. And in our work for FSCO on auto insurance companies in Ontario, FSCO assumed that equity closely approximated invested assets.

c): We don't know since we do not know how invested assets have been allocated by the insurance companies across their many lines of business and across Canada. Moreover, the investment income does not appear to include capital gains. The MSA and GISA data differ significantly from the audited statements, which we did not have available, and hence, we cannot be sure of what is excluded in the audited statements.

3. a): In our tables 7 and 8, the loss ratio for 2016 is 74%, not 87%.

b): We didn't give any consideration to the differences because the data we used were annual data.

4. This is the value used by FSCO to determine auto insurance rates in Ontario. It is incorporated into their formula. As far as we know, FSCO has been using this assumption at least throughout the period 2000-2015. We can make available the report we prepared for FSCO where we used this assumption with the approval of FSCO.

5. There are no jurisdictions in Canada that rely on the methodology we have used, which is the core of Finance courses around the world. We can speculate as to the reasons for this. But based solely on our experiences with FSCO and the Ontario Energy Board, where we were retained to estimate appropriate ROEs for the regulated local electric utilities, the regulators succumbed to the pressures of the regulated industries.

6. The years 2014 and 2015 are left blank because in both years, the aggregate ROEs were negative and thus obviously below our estimates of appropriate ROEs for this industry in Newfoundland and Labrador.

7. ROE Gaps (%)

	2011	2012	2013	2014	2015	2016	Avg. 2011-16
All companies	10.4	7.8	1.7	-24.3	-43.1	0.6	-8.6
All ex. Primum and Security National	10.5	6.6	2.6	-18.8	-16.2	15.5	0.2
Positive ROEs	34.3	16.4	5.6	-21.2	-19.6	19.1	6.0

8. Estimated Premium Overpayments/Deficiencies (\$M)

Due to the complexity of the procedure we originally used, and thus to save time, we resorted to option 1 ("short-cut" methodology) as described on p. 28 in our report. This methodology generated lower premium overpayment estimates than did the methodology we used.

	2011	2012	2013	2014	2015	2016	Total. 2011-16
All companies	\$12.8	9.3	1.9	-29.3	-61.7	0.9	-66.1
All ex. Primum and Security National	12.3	7.6	2.8	-20.7	-20.7	20.8	2.0

Positive ROEs	33.7	15.6	5.0	-19.5	-19.5	19.5	34.8
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9. Estimated Premium Overpayments/Deficiencies (%)

	2011	2012	2013	2014	2015	2016	Total 2011-16
All companies	6.1%	4.6	0.9	-12.2	-22.6	0.3	-4.6
All ex. Primmum and Security National	6.2	4.0	1.4	-9.5	-8.6	8.4	0.2
Positive ROEs	19.8	9.8	3.0	-10.3	-10.0	10.00	3.2

10. a): We started with the Oliver Wyman direct aggregate expense ratios. The general expense ratios in the direct aggregate ratios were consistently greater than the general expense ratios in the GISA data. So we combined the Oliver Wyman estimates for commissions and premium taxes and fees with the GISA estimates for general expenses to generate our aggregate expense ratios. We used the Oliver Wyman estimates for commissions because we believed that they more accurately reflected what was happening in the auto insurance market. We used the GISA estimates for general expenses because we believed that they more accurately reflected cost cutting initiatives by the insurance companies.

b): Our estimates, being a hybrid, likely approximate the direct operating expenses.