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October 12, 2018

BOARD OF COMMISSIONERS OF
PUBLIC UTILITIES
PO BOX 21040
120 TORBAY ROAD
ST. JOHN'S, NL A1A 5B2

VIA EMAIL AND COURIER

(E) JGLYNN@PUB.NL.CA

ATTENTION: JACQUIE GLYNN

Dear Ms. Glynn:

RE: FINAL SUBMISSION FROM IBC

On behalf of the Insurance Bureau of Canada, please find enclosed the Final Submission for the auto insurance review process carried out by the Board of Public Utilities of Newfoundland and Labrador.

We trust this is satisfactory.

Yours truly,

~~MARTIN WHALEN~~ HENNEBURY STAMP

for **KEVIN F. STAMP, Q.C.**
KFS/XNB

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October 12, 2018

Darlene Whalen, Chairperson
Public Utilities Board,
Automobile Insurance Review
P.O. Box 21040
St. John's, NL A1A 5B2

To whom it may concern:

Attached is the final submission from IBC in the auto insurance review process carried out by the Board of Public Utilities of Newfoundland and Labrador.

On behalf of our member companies, thank you for the opportunity to participate in this process.

Regards,

Amanda Dean
Vice-President, Atlantic
Insurance Bureau of Canada

Enclosure

IBC BAC | Insurance Bureau of Canada
Bureau d'assurance du Canada

Newfoundland and Labrador

Auto Insurance Review

IBC Final Submission

~ October 2018 ~

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Introduction

IBC's final submission focuses on correcting many of the incorrect statements that were made by intervenors during the Public Utilities Board (PUB) automobile insurance review hearings, and highlights methodology errors in reports presented by the Campaign to Protect Accident Victims (the Campaign). It also reiterates the consumer benefits in IBC's recommendations.

Misinformation During Public Hearings

There were a large number of incorrect statements made by some intervenors during the PUB hearings. These statements primarily focused on industry profitability, market concentration, property damage claims costs, and industry reserving practices.

Insurance Industry Profitability

Intervenors made numerous inaccurate claims about industry profitability throughout the PUB hearings. The Atlantic Provinces Trial Lawyers Association (APTLA) and the Campaign claimed that insurance companies in the province earned profits of $100 million dollars per year. Examples of some of these claims are below:

> *"These are the same insurance companies who, although the Superintendent of Insurance says that they made 100 million dollars in 2016, take the position before the Board that they have lost money, that they are losing money"*[1]
>
> *"...the insurance industry throughout the province of Newfoundland and Labrador makes in excess of 100 million dollars per year"*[2]

The Campaign reiterated this statement during its presentation to the PUB[3]. Intervenor claims of $100 million in profit were based on an incorrect understanding of Superintendent of Insurance publications. Using these publications, the intervenors subtracted total claims from total premiums to derive a $100 million estimate. However, Superintendent publications do not include additional insurer costs such as commissions, insurance premium taxes, or general expenses. According to the General Insurance Statistical Agency (GISA), an organization mandated to collect certain insurer information, these additional costs were equal to 25.7% of premiums[4].

As outlined in Oliver Wyman's Newfoundland and Labrador *Profit and Rate Adequacy Review – Private Passenger Automobiles* (Profit Report), the province's auto insurance industry is in a precarious position. According to that report, between 2012 and 2016 actual average premiums have been, on average, 11.2% deficient. In 2017, rates were projected to be approximately 15% deficient. Oliver Wyman's report underscores the importance of stabilizing claims costs so that consumers will not be forced to bear the burden of increasing insurance premiums.

[1] June 5 transcript, page 12
[2] Ibid, page 18
[3] Campaign presenation, September 10
[4] GISA, 2016

Newfoundland and Labrador drivers do not want to see premium increases of the magnitude outlined in Oliver Wyman's Profit Report. To reduce claims costs and manage the need for premium increases, IBC believes that the introduction of a $5,000 minor injury cap on non-pecuniary damages is the best route to restoring stability for the province's drivers. This reform, in addition to IBC's recommendation to increase Section B benefits and introduce pre-approved treatment protocols will result in both a better operating environment for insurers, and greater benefits for the province's drivers.

Insurance Company Market 'Stronghold'

During the hearings, the Campaign noted that in 2016, the top four auto insurers in Newfoundland and Labrador had a combined market share of 87%. It then noted that in 2003, the top eleven insurers held a roughly comparable market share. The Campaign attributed the increased market concentration to insurance companies acquiring or integrating with other companies, implying that the province's auto insurance market is healthy.

In reality, the increased market concentration between 2003 and 2016 was due to insurers exiting the Newfoundland and Labardor auto insurance market. Indeed, 5 of the top 13 insurers in the Maritimes do not currently write business in Newfoundland and Labrador. The past and projected premium deficiencies highlighted in Oliver Wyman's Profit Report underscores this difficult reality for the province's remaining insurers.

IBC's recommendations will help stabilize claims costs, and encourage insurers to re-enter the province's auto insurance market. It is also important for the Department of Service Newfoundland and Labrador to consider IBC's rate regulation reform recommendation. Though it is recognized that this component of the review is outside the scope of the Board of Commissioners of Public Utilities (PUB), it is mentioned here in the spirit of transparency.

Increase in Property Damage Claims

Many intervenors assert that there has been an increase in property damage claims, and that this increase is leading to rising premiums for consumers. For example:

> "*...the cost of property damage has increased significantly in our province, thereby giving rise to an increase in the average cost of insurance premium*"[5]
>
> "*the value of vehicles have increased, so has the cost to repair the vehicles. The payout of the claims have to clearly identify the property damage component.*[6]"

These assertions are not borne out by recent GISA data. Property damage claims costs per vehicle have not increased in recent years, as shown in the table below:

[5] June 5 PUB transcript, page 13
[6] Ibid, page 27

Newfoundland and Labrador Property Damage Loss Costs

Year	Property Damage Loss Costs
2012	$116
2013	$112
2014	$119
2015	$116
2016	$114
Cumulative Change	(1.8%)

IBC table with data from GISA.

Property damage costs on a per vehicle basis have been stable, not increased, over the most recent five-year period.

While property damage claims costs have remained stable, IBC recommends changes to the province's existing property damage framework to make it easier for consumers to settle property damage claims. Specifically, IBC recommends introducing a Direct Compensation Property Damage (DCPD) framework, similar to that of New Brunswick. This will permit drivers to deal with their own insurer to repair damage to their vehicle following their not at-fault collision, rather than with the at-fault driver's insurer.

In reality, it is bodily injury claims costs, not property damage claims costs, that are responsible for Newfoundland and Labrador consumers paying significantly more for insurance than consumers in the Maritimes. This was also highlighted by the Campaign's actuary, Craig Allen, who confirmed that bodily injury costs per vehicle are roughly twice as high in Newfoundland and Labrador than they are in Nova Scotia and New Brunswick[7].

Adding Industry Reserves to GISA Data

During the PUB hearings, an intervenor claimed that IBC adds an aggregate reserve to all data collected on behalf of GISA.

> *"...if I went on GISA right now, looked at the GISA data, that would include the claims reserve put on by the adjuster and it would include the aggregate or supplemental reserve that's put on by the IBC's actuary, correct?"*[8]

This is incorrect. IBC does not alter the data it provides to GISA in any way. In reality, GISA contracts IBC to collect specific claims data that has been requested by provincial regulators. Insurer claim information collected by IBC includes individual case reserves set by insurance company adjusters. Once this collected claims data is delivered to GISA, its actuary, Ernst & Young, completely independently of IBC, adds its own industry aggregate reserves to account for claims that have been incurred but not yet reported. IBC adds no reserves to any data it collects on behalf of GISA.

[7] September 11 PUB transcript, page 127
[8] June 8 PUB transcript, page 121

Intervenor Submissions

There were a number of submissions made on behalf of other intervenors which contained incorrect or misleading information due to the limited view taken in these submissions. IBC believes that the PUB should be aware of the limitations and inaccuracies presented in these reports, which are discussed below.

Dr. Karl Misik Comments

During the hearings, Dr. Misik presented his report which was written at the request of the Campaign. During the hearings, Dr. Misik indicated that the Campaign informed him of a proposal to cap Section B benefits on claimants. When referencing their conversation, Dr. Misik stated that

> *"...he explained there is, that there will be a cap and therefore I thought that that was totally wrong..."*

IBC then asked Dr. Misik to clarify his stance,

> *"And you understood him to say that it would be a cap on Section B, you thought that would be totally wrong?"*

Dr. Misik confirmed this statement. It appears that Dr. Misik had been misinformed that the hearings involved a proposal to cap Section B benefits. Dr. Misik did not appear to be aware of IBC's recommendation to *increase* Section B benefits. IBC's recommendation includes an increase in coverage levels from $25,000 to $50,000, implementing pre-approved treatment procols similar to those in Nova Scotia and Alberta, and making Section B benefits mandatory. These recommendations would result in Dr. Misik's patients being eligible for faster treatment, with higher coverage limits, than the current Section B benefits provide.

Lazar-Prisman Report

Throughout Dr. Lazar and Dr. Prisman's (the authors) report, written on behalf of the Campaign, the authors' frequently misunderstand important insurance profitability metrics. This may be due to the authors' backgrounds as economists rather than actuaries. Accordingly, the authors' report make multiple errors in arriving at their claims of 'premium overpayments' paid by the province's drivers. These errors include the following:

- Misinterpretation of industry return-on-investment (ROI) figures;
- Misunderstanding and incorrectly comparing different GISA reports, which result in their incorrect, fabricated operating expense ratios;
- Ignoring the difference in methodology between accident year and financial year data, and
- Relying on an inappropriate ROE model that, by the authors own admission, is not used anywhere for PPV auto insurance.

Misinterpretation of ROI Estimates

The authors falsely refer to their ROI estimates as 'GISA Pre-Tax Investment Returns'. This is inaccurate, as their ROI figures are not from GISA. Those returns are the authors personal ROI definition calculations. The authors also estimated insurance industry ROI figures using a different formula than that used by Oliver Wyman, and a formula which is widely accepted and used by insurance industry actuaries. Comparisons between the authors' and Oliver Wyman's ROI figures are shown in the table below.

ROI Estimates

Year	Lazar-Prisman ROI	Oliver Wyman ROI
2012	15.1%	4.0%
2013	10.9%	2.8%
2014	13.0%	3.9%
2015	14.4%	2.3%
2016	6.7%	2.4%

IBC table with data from Lazar-Prisman Report, Page 15.

Oliver Wyman calculated the insurance industry ROI based on an insurer's invested assets. Invested assets are insurers' equity plus reserves. By comparison, the authors admitted that their ROI calculation did not include reserves because, they claimed, they did not have access to the data.

The PUB asked the authors why they treated their own ROI calculations and Oliver Wyman's calculations as equivalent, when they are two completely different calculations. In explaining their calculation, the authors responded only that:

> *"As noted, we assumed invested assets and equity to be the same..."*

During the PUB hearings, Ms. Elliott noted that in regards to the authors' ROI calculations,

> *"...ROI is Return On your investments which is a ratio of your investment income divided by your invested assets. What's presented here* [authors' ROI calculations] *in this row is the investment income divided by the equity and the* ***equity does not equal the invested assets.****"*[9]

Ms. Elliott noted that the authors' ROI calculations seemed inaccurate. Specifically, she stated that:

> *"...insurance companies are required to invest conservatively. Most of their investments, a large proportion are in government grade bonds. And we know that government grade bonds are risk free with a very low interest rate.*

[9] June 6 PUB transcript, page 86. Square brackets added by IBC for clarification.

*And so, **if you see this measurement as presented by Lazar, you know, double digit, 15 percent, we know that that would be a red flag** because we know that government bonds that companies invest in are not 15 percent. **So, it's a different, it's something else. It's not an ROI.**"*[10]

Additional sections of the authors' report expose their lack of understanding of the insurance industry. For example, when calculating 'premium overpayments', the authors used an ROI assumption of 6% because they incorrectly believed that was the current figure used by FSCO[11].

FSCO does not currently use a 6% ROI assumption for rate filings. The authors were unable to provide a source for their assupmtion when questioned about it by the PUB. During the PUB hearings, Ms. Elliott confirmed her understanding that FSCO does not currently use a 6% ROI in its assumptions.

Incorrect Expense Ratios

In their report, Dr. Lazar and Dr. Prisman manufacture artificially low operating expense ratios, and compare these to Oliver Wyman Profit Report operating expense ratios. This is done to support the authors assertion that Oliver Wyman's estimated industry ROEs were inaccurate.

However, Oliver Wyman did not calculate the operating expense ratios used in its Profit Report. They were taken directly from GISA's *Automobile Insurance Financial Information Industry Expense Report Private Passenger Automobile* (Industry Expense Report). Ms. Elliott confirmed this during the PUB hearings.

To manufacture lower expense ratios, the authors combined expense categories from two separate GISA reports: its Industry Expense Report, and its Industry Profit & Loss Report (P&L Report). During the PUB hearings, Ms. Elliott noted that the P&L Report only relies on a subset of expenses, not all industry expenses. Ms. Elliott then stated she did not know why the authors would combine data from two separate reports to make their new expense ratios, and stated that:

"...I don't agree with their number. They're missing a component of the general expenses."[12]

And that,

***"I'm going to assume that the author misunderstood the data.** I don't know why or what was provided to Dr. Lazar, but perhaps did not have the complete information that would be required to present the expense information."*[13]

[10] September 6 PUB transcript, pages 91 - 92
[11] Authors report, page 30
[12] September 6 PUB transcript, page 99
[13] Ibid, pages 100 - 101

Additionally, the PUB asked Dr. Lazar and Dr. Prisman to explain why their expense ratios were lower than either GISA exhibit. The authors provided no sufficient explanation.

Incorrect Comparison of Financial vs Accident Year Loss Ratios

In their report, the authors used an industry loss ratio of 79% to calculate 'premium overpayments', which they claim is approximately halfway between a GISA 2016 financial year loss ratio, and an Oliver Wyman 2017 accident year loss ratio. These two types of loss ratios are entirely separate calculations that measure two different types of insurance company activities.

In questioning the authors on why they chose to average the two separate ratios together, the PUB asked whether any consideration was given to the differences between accident year versus calendar year loss ratio definitions. The authors admitted that they gave no consideration to the differences.

During the PUB hearings, Ms. Elliott was asked whether she saw any merit in combining accident year and financial year loss ratios to create a new metric. In response, she said:

> *"It's not what I would do… they've taken an apple or an orange and if you will and average them together.[14]"*

Insurance regulators across Canada have mandated reporting processes for both accident year and financial year data. This is done because they serve different purposes. Averaging accident year and financial year loss ratios is not an actuarial practice. The authors' decision to do so displays their lack of understanding of insurance industry financial calculations, and the role of insurance regulators.

Capital Asset Pricing Model

The authors attest that the 10% ROE permitted by the PUB was too high, and that a separate Capital Asset Pricing Model (CAPM) model should have been used for PPV auto insurance instead. The authors justified this position by stating that in the past, they had recommended that FSCO adopt this model for PPV auto insurance.

The authors admitted that their recommendation was not adopted by FSCO and has never been implemented for PPV auto insurance. During the PUB hearings, Dr. Lazar also admitted that no jurisdiction uses the CAPM model for PPV auto insurance.

Missing Companies

The authors excluded a large number of Newfoundland and Labrador insurers from their report. During the PUB hearings, the Campaign questioned Paula Elliott on whether it is appropriate to exclude certain companies from an ROE analysis, relating to the authors' chosen methodology[15]. Ms. Elliott replied that it is not appropriate to exclude some companies when conducting an ROE analysis. Specifically, Ms. Elliott stated:

[14] September 6 PUB transcript, page 114
[15] Ibid, page 25

"I see no reason to exclude any companies if we're trying to measure what the results were in the past.";

"If you want to exclude some companies, go ahead and do that, but I don't see the appropriateness of just cherry picking who you want to exclude."; and

"Looking back and making artificial measurements of the past results because you exclude the low people, the low insurers, I'm not sure what that achieves. You can do it, but you're just giving hypothetical results of what the profits would have been if we exclude the low ROE insurers."[16]

In addition to excluding insurers with ROEs below an arbitrary threshold, the authors omitted additional insurers that were presented in Superintendent of Insurance publications. The Superintendent publication contained premium information on additional companies that were not in the authors' source data. During the hearings, Dr. Lazar admitted that he did not look at Superintendent of Insurance publications, and therefore, those additional companies were also excluded from the authors' analysis.

<u>Other Issues</u>

During the PUB hearings, Dr. Lazar suggested that insurer operating expense ratios and projected ROI don't matter. Dr. Lazar stated,

"...premiums are too high, plain and simple regardless of what expense ratio you plug in, regardless what return on investment you plug in because you used the wrong return on equity."[17]

Dr. Lazar's suggestion that there are situations where insurers' operating expense ratios and investment income do not matter highlights his lack of understanding of how auto insurance rates are set, and of the PUB's role in regulating them. In reality, insurers are required to provide data on both operating expense and investment income during rate filings.

Craig Allen Report

The information contained in Craig Allen's report, *Actuarial Report for the Campaign to Protect Accident Victims*, omits important contextual information related to premiums and claims costs in Newfoundland and Labrador, particularly when making comparisons with Nova Scotia and New Brunswick.

<u>Average Premium and Claim Costs</u>

Mr. Allen's report stated that since the previous peak of $1,035 in 2003, the average written premium has increased relatively slowly, to $1,123 in 2017. This statement ignores any reference to how premiums in Nova Scotia and New Brunswick have

[16] September 6 PUB transcript, pages 25 - 27
[17] September 13 PUB transcript, pages 174 - 175

changed over the same time period following minor injury cap implementation in those jurisdictions.

In response to IBC's submitted written questions, Mr. Allen admitted that in 2016, both the average premium and total claim cost per vehicle were several hundred dollars higher in Newfoundland and Labrador than in Nova Scotia and New Brunswick.

During the PUB hearings, Mr. Allen also admitted that bodily injury claim frequency is higher in Newfoundland and Labrador than in Nova Scotia or New Brunswick, and that Newfoundland and Labador bodily injury loss costs are roughly twice as high as in those provinces.[18]

<u>Minor Injury Cap</u>

In his written report, Mr. Allen often referred to the Newfoundland and Labrador bodily injury claim frequency rate, while omitting relevant comparisons of bodily injury claim cost per vehicle (loss cost).

In its written questions, IBC asked Mr. Allen whether it was reasonable to assume that a minor injury non-pecuniary damages cap in Newfoundland and Labrador would be expected to result in lower bodily injury loss costs the following year. In his written responses, Allen responded that if all else remained equal, one could expect that the bodily injury loss cost would be lower with the introduction of a cap. He then reaffirmed this view in response to IBC questioning during the PUB hearings[19].

Mr. Allen's response confirms that both actuaries participating in the PUB hearings, himself on behalf of the Campaign, and Oliver Wyman at the request of the PUB, believe that a minor injury non-pecuniary damages cap will lower costs in Newfoundland and Labrador.

Conclusion

The PUB auto insurance review provides an important opportunity to address the province's higher bodily injury claims costs. These higher claims costs are why Newfoundlanders and Labradorians pay 35% more, on average, for auto insurance than drivers in the Maritimes, and are a contributing factor in why many insurers have left the province. Both Mr. Allen and Oliver Wyman have confirmed that a cap on non-pecuniary damages would be expected to lower these bodily injury claims costs in the province.

IBC recommends the implementation of a $5,000 minor injury non-pecuniary damages cap, linked to inflation, significant improvements to Section B benefits, the introduction of a DCPD framework to facilitate faster vehicle repairs, and a transition to a more market-based rate regulation framework. These recommendations will improve health outcomes while stabilizing claims costs, and create a more competitive automobile insurance market for consumers.

[18] September 11 PUB transcript, pages 126 - 127
[19] Ibid, pages 120 - 121