NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES
120 Torbay Road, P.O. Box 21040, St. John's, Newfoundland and Labrador, Canada, A1A 5B2

Hearing Transcript

2017 Automobile Insurance Review

September 13, 2018

PRESENT:

The Board:
Darlene Whalen, Chair and CEO
Dwanda Newman, Vice-Chair
James Oxford, Commissioner

Board Counsel/ Staff:
Ryan Oake, Regulatory Analyst
Peter O'Flaherty, Q.C., Hearing Counsel

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Atlantic Provinces Trial Lawyers Association
Ernest Gittens

Campaign to Protect Accident Victims
Colin Feltham
Jerome Kennedy, Q.C.

Consumer Advocate
Dennis Browne, Q.C.
Andrew Wadden

Insurance Bureau of Canada (IBC)
Amanda Dean
Kevin Stamp, Q.C.
Trevor Foster

Spinal Cord Injury NL
Thomas Fraize, Q.C.
Lara Fraize-Burry
Michael Burry

Presenters:
Dr. Fred Lazar
Presenting on behalf of the Campaign

(9:15 a.m.)
CHAIR:
Q. Good morning, everybody. I guess we're going to go right to the Campaign. You can introduce your presenter.
MR. FELTHAM:
Q. Thank you, Chair. Good morning, Chair and Commissioners. This morning we have Dr. Fred Lazar with us, and Dr. Lazar is here to review or present, I guess, his report which has been supplied to the Board entitled, "Estimated Overpayments of Automobile Insurance Premiums in Newfoundland and Labrador 2012 to 2016", which has already been filed with the Board. I'll note that the report is co-authored with Dr. Eli Prisman, and Dr. Prisman could not be here today, only Dr. Lazar was available, given we were only working with a small set of dates. I did, and I hope it was received, supply two CV documents; one for Dr. Lazar and one for Dr. Prisman to the Board. So the CV of Dr. Prisman, it is available, even though he isn't present. Good morning, Dr. Lazar?

DR. LAZAR:
A. Good morning.
MR. FELTHAM:
Q. Thank you for agreeing to be here today, and to share your thoughts with the Board. I know it was a late arrival for you, or early morning arrival, I guess, really, with some flight issues. I'd like to begin, Doctor, with just reviewing your CV a little bit, some of your background, credentials, and qualifications and that sort of thing. Dr. Lazar, you're a professor at York University?
DR. LAZAR:
A. Yes.
MR. FELTHAM:
Q. And how long has that been the case?
DR. LAZAR:
A. It seems like forever. I've lost track, 45/46 years.
MR. FELTHAM:
Q. And your CV indicates that you're in the Department of Economics?
DR. LAZAR:
A. Department of Economics, cross-appointed

between the Faculty of Liberal Arts and Applied Professional Studies, and Schulich School of Business.
MR. FELTHAM:
Q. And in terms of your role as professor, what sort of – what do you teach there, what are your areas?
DR. LAZAR:
A. My economics area, used to be the Department of Arts, taught just about every course, but primarily international trade and finance, industrial organization which deals with competitive behaviour strategy, and in the business school a course called Economics for Management. It's really the application of economic concepts to decision making.
MR. FELTHAM:
Q. And competitive behaviour strategy, what is that?
DR. LAZAR:
A. That's looking at market structures, how firms compete in different market structures, how those market structures evolve, and discussions of how should companies develop strategies to gain an

advantage in the marketplace.
MR. FELTHAM:
Q. And I note from your CV just in terms of formal education, you graduated from University of Toronto in 1969, went on to complete post-graduate degree at Harvard University, the last of which was a PhD in 1978. What's the PhD in?
DR. LAZAR:
A. It's in economics. My dissertation was on male racial unemployment rate differences in the US, so I started in the labour economics field.
MR. FELTHAM:
Q. And I won't belabour this, but you've listed in your CV a number of books and journal publications and that spans – the ones you've listed here in terms of the journal work runs into about 2015, I believe, and I note that one of the journals referred to is, if we look at the bottom of page two, risk management and insurance review?
DR. LAZAR:
A. Yes.
MR. FELTHAM:

Q. And the title of the article is, "Regulator's Determination of Return on Equity in the Absence of Public Firms: The Case of Automobile Insurance in Ontario".
DR. LAZAR:
A. Yes.
MR. FELTHAM:
Q. And that was in 2015?
DR. LAZAR:
A. Yes.
MR. FELTHAM:
Q. And that's a peer review journal?
DR. LAZAR:
A. All of these are.
MR. FELTHAM:
Q. Okay, and that was co-authored with Dr. Prisman as well.
DR. LAZAR:
A. Yes.
MR. FELTHAM:
Q. Is that of a similar nature to what you've done here in terms of the subject matter?
DR. LAZAR:
A. No, it really is an extension of the work that we did for FSCO, where, you know,

traditionally in applying the capital asset pricing model, one uses data for public companies. In this particular case, we were dealing with largely a mix of public and private companies. Even the public companies, there was really no public data available, so we had to resort to use of accounting data rather than publicly reported financial data.
MR. FELTHAM:
Q. And if I go to page three of your CV, I note you've listed quite a number of instances when you've worked as expert witness?
DR. LAZAR:
A. Yes.
MR. FELTHAM:
Q. In different types of hearings. It appears largely regulatory type hearings?
DR. LAZAR:
A. Yes.
MR. FELTHAM:
Q. And the last one, I guess, this is what you're referring to work with FSCO, indicates Financial Services Commission of Ontario, calculating the return on equity

for automobile insurance companies in Ontario. When you mentioned you worked for FSCO, is that what you were talking about?
DR. LAZAR:
A. Yes. Eli and I were retained by FSCO because they had to respond to the Auditor General of Ontario's comment that they hadn't reviewed the return on equity in about 15 years, so we were retained to examine how they would determine what might be an appropriate return on equity for automobile insurance companies.
MR. FELTHAM:
Q. And then if we move on to your professional consulting activities, and it says in brackets over 40 years, I guess, there appears to be – you've done a mix of public and private in that regard?
DR. LAZAR:
A. I started basically in the public sector, more idealistic at the time, and I don't think it really have changed, just learned a lesson of how the system works, and then sort of evolved into the private sector, and then more recently combining the two.

MR. FELTHAM:
Q. And in terms of the work that you've done here that we're going to discuss today, have you done work of a similar nature before?
DR. LAZAR:
A. Again the original work was for FSCO. Prior to that, Eli and I did comparable work for the Ontario Energy Board with regards to local electricity distribution companies, and following that work for FSCO, that's when the Ontario Trial Lawyers contacted us and asked us just to apply a methodology to the experience in Ontario, so that's sort of the history in this particular area.
MR. FELTHAM:
Q. And I'll get to the Ontario Trial Lawyers piece in just a second. Before I do, the Ontario Energy Board work, can you explain what was done there? Who was the client, I guess, and what was - more specifically what you were doing?
DR. LAZAR:
A. It was again the Ontario Energy Board, the regulator, and I believe in their case as well it was the Auditor General that had

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suggested that they review their determination of rate of return on equity rules for the local electricity distributors. So it was similar work that we did with FSCO, but a different sample, different group of companies.

MR. FELTHAM:

Q. And then you mentioned for the Ontario Trial Lawyers Association. A couple of those gentlemen were here yesterday. When did you – I guess, what did you do for the Ontario Trial Lawyers Association and when?

DR. LAZAR:

A. I'm trying to remember the original one, 2014, 2015, they asked Eli and me to look at what had been the experience in Ontario to try to assess whether consumers of automobile insurance were paying the right price, paying too much, too little, and they've come back to me on two other occasions, 2016 and this year, to update the reports, which I have done. Again I've taken the original report and just incorporating more recent data into the analysis.

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MR. FELTHAM:

Q. Same methodology, just changing the data to update?

DR. LAZAR:

A. Methodology is not going to change, just the data have changed.

MR. FELTHAM:

Q. Dr. Lazar, at a high level, what were the results in Ontario from this study?

DR. LAZAR:

A. At the high level, again what sort of underlied our methodology, so the original work, and then the follow up work was to look at the estimates of the actual realized returns on equity of the individual insurance companies, and then collectively, and compared that to what should have been an appropriate return on equity. Also looking at what might have been a more appropriate expense ratios over time in light of technological developments.

MR. FELTHAM:

Q. And what was found in Ontario in terms of the results?

DR. LAZAR:

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A. Again the realized returns on equity have for most companies far exceeded what would have been appropriate levels, and the gap had risen, at least up until las year, so that there seemed to be an indication that there were significant overpayments for automobile insurance.

MR. FELTHAM:

Q. And you describe it as overpayments. What do you mean by that?

DR. LAZAR:

A. Again if the regulator in Ontario's FSCO, if they had gone with the recommendations we made and incorporated those return on equities in their rate determinations, then the premiums that would have been awarded or permitted, and this is really sort of a maximum the insurance companies could have always charged less for competitive reasons or for other reasons, that those premiums would have been less than the premiums that are actually charged inferred from their realized returns on equities.

MR. FELTHAM:

Q. So in terms of the return on equities or the

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return on equity was in excess of what, in your opinion, the appropriate target return on equity would have been?

DR. LAZAR:

A. Yes.

MR. FELTHAM:

Q. Okay.

DR. LAZAR:

A. I mean, the correct analysis, and because of lack of data, we had to use this methodology, would have been to look at, okay, what were the premiums that were actually awarded based on the information available when the premiums were permitted, and compare those premiums to what they should have been with different return on equities, you know, Eli and my estimates, and what would have been more reasonable expense allowances, and the gap between those two would have been a measure of the overpayments.

MR. FELTHAM:

Q. And I gather then the – I mean, we've talked about Ontario thus far and the work that you did there with respect to return on equity in automobile insurance companies. In terms of this report, your report, July, 2018, you've now at the request of the Campaign to Protect Accident Victims, taken that methodology and applied it to Newfoundland and Labrador data, is that correct?

DR. LAZAR:

A. The difference is that we had to apply the capital asset pricing model to those insurance companies operating in Newfoundland in determining what would have been, based on that model, appropriate returns on equities, and they differed from those in Ontario largely because if you applied the capital asset pricing model, there was a different data, a different risk factor, slightly higher one for Newfoundland than for Ontario.

MR. FELTHAM:

Q. Okay, and we'll get a little bit more into that. I'll get you to explain it somewhat further in the report, but if we start at the top here, I guess, and look at page four of your report, here we have your executive summary. So you've laid this out in four

points. You've indicated that you've looked – well, it's done in a question form, but number one, "Are the conclusions of the report by Oliver Wyman for the Board of Commissioners of Public Utilities for Newfoundland and Labrador valid", and I'm going to change the order a little bit and I'm going to deal with that issue last as we go through the report, or I'd like you to deal with that issue last. Going to number two, "What has been the real experience of auto insurance companies in Newfoundland and Labrador"? What do you mean there when you say, "What has been the real experience"?

DR. LAZAR:

A. Okay, again Eli and I used data provided by MSA Research, and they use – they rely on GISA data and other data. So we had, I think, 15/18 companies, somewhere in that range. I apologize, I do not remember the exact number. I can look in the appendix and see the exact number. What we did was let's estimate what their actual return on equity for their operation in Newfoundland and Labrador had been, and compare those to

our estimates of what should have been the regulated return on equity, and whenever they were greater, obviously that was an indication that, you know, the premiums that were allowed were greater than what they would have been or should have been if our return on equity numbers had been used.

(9:30 a.m.)

MR. FELTHAM:

Q. And you mentioned MSA Research. Let's just deal with that for a second. I guess, what is that and why was that necessary to do that, to use them?

DR. LAZAR:

A. We originally approached GISA for data on individual companies. In the absence of having data on individual companies, you can't apply the capital asset pricing model. The data don't exist. Again Eli was conducting sort of negotiations. For whatever reason, GISA was either unwilling to provide us with the data in the format we required, or the cost proved to be excessive, so we then resorted to MSA, whom we had used for the work we did for FSCO.

So we were familiar with them, and they were able to format the data for us so that we could input it into the model very quickly, and we could do it on schedule and at much lower cost.

MR. FELTHAM:

Q. I mean, what is MSA Research, what are they?

DR. LAZAR:

A. I've got it here, the official name. Okay, MSA Research, they work with what's called the National Insurance Conference of Canada and they essentially – I'm not sure if they're an independent group or – they do work with GISA, they do get data from GISA, as well as from the insurance companies, and I know in the work we did for FSCO, FSCO relied considerably on this group for data for rate determinations.

MR. FELTHAM:

Q. So number two, "What has been the real experience of auto insurance companies in this province". Number three, "How does this experience compare to what would have been considered a fair return on equity for these companies", and we'll get into this in

some more detail, and I think you've sort of already mentioned this, but what are we talking about there?
DR. LAZAR:
A. Essentially, again the gap between the realized returns on equities, and the return on equities that Eli and I estimated would have been appropriate in light of financial market developments.
MR. FELTHAM:
Q. Okay. Finally, the fourth item, "What are the implications for the aggregate premiums paid by drivers in Newfoundland and Labrador", what does that mean?
DR. LAZAR:
A. Which one is this?
MR. FELTHAM:
Q. Sorry, number four, "What are the implications for the aggregate premiums paid by drivers in Newfoundland and Labrador". I'm just wondering what are we talking about there?
DR. LAZAR:
A. Okay, I thought you were referring to point four here.

MR. FELTHAM:
Q. Oh, no, sorry.
DR. LAZAR:
A. The implications, again depending on what sample of companies you use, that there seemed to have been over this period of 2013 to 2016, overpayments that ranged, I believe, depending on the methodology, somewhere between 4 or 5 percent, and 9 percent.
MR. FELTHAM:
Q. Before we leave your executive summary because it's expanded upon a little bit in terms of summary answers, I guess, to the issues, I'd like to review that and then we'll get into a little bit more detail about how you got there. So if we start with, and again I mentioned I'm going to skip over number one here, which is the conclusions of Oliver Wyman, we'll get back to that, I want to focus first on the work that you did and your own estimations. So number two, "ROE's for auto insurance companies in Newfoundland and Labrador", and you note here, "When we exclude the TD

subsidiaries, Primmum and Security National, and three other companies with average negative ROE's over the entire period, 2011 to 2016, the weighted average ROE's for the remaining companies increased 12.2 percent over the period, 2011 to 2016. Obviously, the companies that have been profitable have been very profitable". So, I guess, essentially then you determined once you took certain, I'll call them under performing companies from the analysis, that the results were positive ROEs?
DR. LAZAR:
A. Yes, but they were positive for the entire sample. They were just much larger when you excluded those particular companies.
MR. FELTHAM:
Q. And then, I guess if we look at the next step here, if we go over to page 5 and item 3, "How much have consumers in Newfoundland and Labrador overpaid?" And this I guess is the answer to the comparison of the realized ROEs versus what the targets ought to have been?
DR. LAZAR:

A. Yes.
MR. FELTHAM:
Q. And you note there that, "For the companies with average positive ROEs, the estimated upper limit for aggregate overpayments is \$92 million. For the companies with positive ROEs, the estimated overpayments represent about 8.6 percent of the total premiums paid between 2011 and 2016." And there's smaller print in italics below that.
DR. LAZAR:
A. Right.
MR. FELTHAM:
Q. Which notes that, "For all companies, excluding Primmum and Security National, the upper limit for aggregate overpayments during the period 2011 to 2016 is 54 million dollars." So, let me see—I want to make sure we understand this. So, I gather that you're giving us a range here, depending on whether we just exclude the two TD companies or also exclude a couple of others who have had similar negative performance and that for that five-year period, 2011 to 2016, I guess it's five years, anyway 2011 to 2016,

the overpayment estimate is somewhere between 54 million dollars and 92 million dollars for consumers in this province?

DR. LAZAR:
A. Yes, but as we point out, that's sort of the upper limit.

MR. FELTHAM:
Q. Yes.

DR. LAZAR:
A. Were there over the entire period overpayments? Most likely. What was the value? As I said, the only way to determine that with greater certainty is if one had access to sort of other data. What were the aggregate premiums that were permitted to the insurance companies? And two, what would have been the aggregate premium permitted to the insurance companies with lower return on equity assumptions, lower operating expense assumptions? And the gap between the two would have reflected the overpayments regardless of what the insurance company—the actual performance of the insurance companies.

MR. FELTHAM:

Q. And Dr. Lazar, I want to pick up on a phrase that you've used there. You say, "If one had access to the data," and we've also talked a lot about estimating. You know, why is it that we're estimating, and you know, why it is that we don't—you know, if one had access to the data? What is it—what are you telling us?

DR. LAZAR:
A. You know, Eli and I don't have access to the decisions made by the Board, at least we didn't have it when we did the report, don't have it now. They might be available. So, we don't know. Here, so the aggregate premiums that were awarded which would have been different from the actual premiums that were paid, you know, if the Board sets an upper limit, it's up to the insurance companies—they can set rates below that for various reasons. In addition, we wouldn't have access to the claims, so expectations that were built into these decisions. So, in the absence of having—not having those data, even though we have return in equity assumptions, we can—I'll have expense

assumptions, there is no way that we could determine what the premiums could have been with a different set of assumptions, so as to be able to simply calculate the differences.

MR. FELTHAM:
Q. And if we go to your report, page 24 next. And so, I gather here what we have is—and you can take us through the explanation, but these are the results in terms of the return on equity calculations for the various insurers over the period examined?

DR. LAZAR:
A. Yes.

MR. FELTHAM:
Q. You earlier mentioned that a couple of companies were excluded, Security National and Primmum Insurance. I gather that's TD Insurance? It's my understanding.

DR. LAZAR:
A. Yes.

MR. FELTHAM:
Q. Yes. And if I look at those, since--well in the case of Security National, since 2013, every year recording a negative ROE, and

ranging from--you know, in 2015 it was negative 247 down to negative 20 I guess in 2013. And Primmum similarly, but from 2014 consistently negative. So, because--you note that some companies were excluded from the analysis. Can you tell us I guess why that was done? What's the economic rationale for doing that and why is it reasonable to do it in your view?

DR. LAZAR:
A. Now, with the case of the TD companies we found similar results in Ontario. That—again, if you apply standard economic reasoning, if a company is consistently losing money then in one particular line of business and this is part of a much broader line of business, they're doing so because they're using that line of business as a lost leader for their other financial services. So, that's what we concluded with TD. I mean, if you look at RBC, they were losing money. I think they've exited from the insurance, auto insurance industry. There are a couple of other companies in Ontario that when they were acquired by

other companies, Fairfax acquired some insurance companies that were doing poorly, within a year or two, Fairfax turned them around. So, if a company is losing money, it's going to either exit the industry if it is not a lost leader, or if it continues in business, it's using this to promote other lines of business. So, they're willing to tolerate a loss here. It's an investment in order to generate profits in other lines of business. Another possibility is that again firms that for one or two years experience negative results, negative returns on equity, losses, they're doing so perhaps to increase market share. So, they're competing more aggressively. They'll cut price to increase market share. If they succeed, then one should expect the prices to sort of rise up. The return in equity is to improve. If that doesn't happen, chances are they'll exit the industry. Then there's a third possibility and this is using transfer pricing to shift around profits from higher tax jurisdictions to lower tax jurisdictions. And if you look at corporate

tax rates at a provincial level, chances are quite good that most of the automobile insurance companies are doing this, trying to perhaps understate their profits in Newfoundland and Labrador because the corporate tax rate is what, 15 percent at the provincial level, and shifting them to lower tax regimes, in particular Ontario and Alberta that have rates, I think what-- Ontario is about 11½ percent, Alberta is 12 percent. Even BC has a lower rate. So, some of the cases might simply be, you know, shift the profits, diminish your profits, perhaps even generate some losses for one reason or another. And again, all of these legitimate reasons for companies to behalf in this way, but that tends to sort of muddy the waters when it comes to trying to figure out, have consumers in this province ended paying too much of the proper amount or too little as a result?

MR. FELTHAM:

Q. Like trying to determine the real experience I guess as you put it?

DR. LAZAR:

A. Yes.

MR. FELTHAM:

Q. If I go to the bottom of page 25, and right— well, I guess it is sort of the last full paragraph that starts with "Furthermore." This is--right above that you reviewed what you just talked about in terms of the experience with TD Insurance and companies of a similar nature, but in—here you say, "Furthermore, the reported or estimated ROEs might be quite misleading with regards to the ability of a company to attract capital to a particular line. As well, without detailed information about the intricacies of intra-corporate transfer pricing and other accounting practices, it is very difficult to measure the real profitability of any one line of business for a P&C company." What are we talking about there?

DR. LAZAR:

A. Okay, and if you look at the major automobile insurance companies that operate in this province, most of them operate automobile insurance in most if not all of the other provinces, and most of them also

operate in other line of business. In the case of the TD subsidiaries, TD also operates in many lines of financial services. So, you're going to have sort of at the corporate level, you're going to aggregate sort of the performance, the revenues, the cost of all of these companies to come up with consolidated statements. And then, you're going to sort of try to establish what the profitability is of your separate business units, but there you have under the accounting rules a certain degree of flexibility and even in the tax rules you have a certain degree of flexibility with regards to transfer pricing. So, transfer pricing refers to what cost can you charge. For example, your automobile insurance operation of Newfoundland and Labrador, that might be provided from their corporate head office or from some other business unit, and can you perhaps increase this cost marginally, again, with the accounting rules and tax laws? Should you reduce this? So that flexibility—here is our real cost which you will report in order to determine internally what's the profitability of the different business units and to determine the performance bonuses for the people running these. And then, from a tax point of view, you'll have different cost allocations in order to try to minimize your tax liability. I don't have privy to those data. Unless you happen to be the tax authority, CRA, nobody else has access to that information other than the companies and a possibility of CRA.

(9:45 a.m.)

MR. FELTHAM:

Q. And if we go over to page 26, Dr. Lazar, table 14, and I'll just—I'll to the paragraph below the table to give us some background here. So, it says, "It is quite clear that the annual returns on investments in equities fluctuate widely from year to year. Therefore, it is not surprising that the annual ROEs of auto insurance companies also fluctuated from year to year. The net investment returns were relatively more stable than the S&P TSX total returns. Furthermore, our estimates of the aggregate

ROIs exceed the ROI assumptions of OW," which is Oliver Wynman, "reinforcing our earlier comments that Oliver Wynman likely has underestimated the profitability of automobile insurance companies in the province and overestimated their premium deficiencies during the period 2012 to '16." Can you take us through—I mean what we seeing here? What's the relevance of this table?

DR. LAZAR:

A. Okay. Now, the P&C companies are going to use sort of the reserves to invest them. You want to earn something on them, and that's sort of a major driver of the profitability. I mean, you look at two classic examples. Warren Buffett with Berkshire Hathaway, really what underlies that operation is insurance, and he's got a phenomenal track record obviously with this team of investing those reserves to generate you know remarkable returns. In the case of Canada, we have Fairfax Financial which again largely a P&C company, and their returns are driven primarily by the ability

of the team, Prem Watsa and his team, to generate superb returns from their investment activities. So, the insurance companies have access and they have to look, how are we going to invest this to sort of generate returns, boost our profitability? And you've got a whole range of financial assets. To simplify them, you know, invest in real estate, you can invest in a whole range of bonds, government to corporate, different sort of ratings, or you can invest in equities. And every insurance company has their own sort of investment strategy. Most, if not all, are going to invest part of this portfolio in equities. And you know, if you invest in bonds, the returns there tend to be more stable. Real estate, less stable than bonds, but more stable likely than equities. Equities are going to be the most variable component.

MR. FELTHAM:

Q. And what are you showing us in the table?

DR. LAZAR:

A. In this particular table, essentially showing that, you know, returns on equity

year to year can bounce around. You can have losses, you can have extremely good returns. The performance of the auto insurance companies, the greater stability I think is the reflection of the fact that they haven't invested 100 percent in equity. There is a mix with a considerable allocation to more stable bonds, but nevertheless, the returns are going to be driven in part by what happens in the equity markets.

MR. FELTHAM:

Q. And if we move down on page 26 to the last paragraph, I'm going to just read that to you. "The auto insurance companies with positive ROEs throughout the 2011-2016 period accounted for about 75 percent of total premiums over the entire period, ranging from a low of 66 percent of total premiums in 2016 to a high of 82 percent in 2011. When Primmum and Security National are excluded, the companies with positive ROEs accounted for 84 percent of the total"—"of the remaining total premiums over the period 2011 to 2016." What's the

significance of that? What -
DR. LAZAR:
A. Oh, just pointing out that the companies that were profitable for this entire period were major players in the market in Newfoundland and Labrador. They weren't a small, you know, relatively insignificant component of that market.
MR. FELTHAM:
Q. Okay. And then, if we go over to page 27, at the bottom, page 27. There we go. I guess there and onto page 28 you explain how you estimated potential overpayments, and you say, "Using these data, we estimated potential premium overpayments as follows. Whenever the realized ROEs exceeded the ROEs we estimated for the auto insurance industry, it is likely that premiums were too high, and as a result, drivers in Newfoundland and Labrador paid too much for auto insurance. In table 16 we report the gaps," and you talked about the gaps earlier, "when they are positive between the realized pre-tax ROEs and the CAPM ROEs for two groups of companies, all companies

excluding Primmum and Security National, and only the companies that reported average positive ROEs over the entire period." So, when the realized ROEs exceeded the ROEs that were estimated to be appropriate, that equals overpayment?
DR. LAZAR:
A. Yes.
MR. FELTHAM:
Q. Okay. And then, page 29, that brings us to your sort of final results, if you will. And if we look at the chart at the top, I guess there's sort of two options, I'll call them options. You either—you have the results with the all companies excluding only Primmum and Security National or all the positive ROE companies? Am I reading that correctly?
DR. LAZAR:
A. Yes.
MR. FELTHAM:
Q. Okay. So, I mean we look at that and you know insurance companies are suggesting private passenger automobile is not a profitable venture in Newfoundland and

Labrador. Are they likely correct about that?
DR. LAZAR:
A. Well, again from an economic theory point of view, if an activity is not profitable, and it's consistently not profitable, you exit that line of business. You leave. You do not stay in it unless it's a lost leader to generate business in other financial or insurance services in that particular jurisdiction. So, if you're not in automobile insurance, you're not going to be a player or you're going to be a smaller player in those other fields. So, you'll take the losses in this activity because you're more than making up for it with profits in other activities. So, it's one or the other. So, you know, the argument is that the auto insurance in Newfoundland and Labrador is not profitable, well, if that were the case, then you look at the committed equity to this industry, the capital. If that argument is correct, you would expect the equity allocated to this business to have declined over time. The

data show otherwise. So that tends to dismiss that argument. So, could it be still unprofitable and your allocation of equity of capital could have increased? Possibly, if this is now being used as a loss leader. But it appears, based on the individual insurance companies, that this might be the case only for the TD subsidiaries, not for the others.

In the case of Intact, which had negative returns on equity I think the last two years, maybe three years, it appears in their case that Intact has been quite aggressive in competing for market share in all lines of business and has been quite successful in doing that, especially when you look at their aggregate profitability and the – while I haven't followed their share price that closely, they seem to have done quite well over different periods of time. So that strategy seems to be working for them, and I suspect if you look at the allocation of capital to this line of business in Newfoundland and Labrador, it has also been increasing, which suggests

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they expect this business to be profitable in the future and this is part of their strategy. They believe they have an advantage in insurance in general across the country and they're simply trying to expand their market share, become a more prominent player to grow more rapidly and then use whatever internal advantages they have to make it more profitable.

But it boils down to if it's unprofitable, you're exiting the business unless it's a loss leader and the data do not support that argument that it's unprofitable and you're exiting.

MR. FELTHAM:
Q. And if we look at page 30, Dr. Lazar, that's where I was going next, which is the capital availability piece that you're speaking of.
DR. LAZAR:
A. Yeah.
MR. FELTHAM:
Q. So, here specifically what were the findings?
DR. LAZAR:
A. Again, there was some decline again for all

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companies 2012 to 2013, but since then, it's been increasing steadily, even during those years like 2014, 2015 where profits eroded quite substantially because of significant increase in claims. Excluding the TD, subs again decline from 2011 through to 2013 but a significant recovery. So, there does not appear to be any indication from these data that there has been any sort of continuous long term decline in the allocation of capital to this line of business in Newfoundland and Labrador.
MR. FELTHAM:
Q. And Doctor, I'd like now to turn to look at little bit at your assessment of some of the Oliver Wyman conclusions in their profitability study. To start, we can go to page nine of your report, and I guess we'll just confirm, but you reviewed as part of the work that you did, and this makes its way into some of your report, the Profit and Rate Adequacy Review, March 29 2018, that Oliver Wyman has done for this Board?
DR. LAZAR:
A. Yes.

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MR. FELTHAM:
Q. Okay. And okay, on page nine, this is your review of the Oliver Wyman key assumptions and one of the issues that is raised in – that you raise and that makes its way into the Oliver Wyman report as well is the use of the ten percent ROE target, and I gather Oliver Wyman is using that as their benchmark. They've accepted that that's what it ought to be, not to have been. And the figure, as I understand it, comes from benchmark setting process that this Board engaged in in 2005 and it's been that way ever since.

But you – I'll put it this way. You take issue with just simply using that ten percent from 2005 as the benchmark. I guess, firstly, I mean, could Oliver Wyman have examined whether a ten percent target was appropriate? Is that something they could have done?
DR. LAZAR:
A. Yeah, I mean, they have access to or could have – yeah, could have easily obtained access to individual company financial

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information, their accounting information. The capital asset pricing model is widely known. It's been around for a long time. Anyone doing any work related to finance would know how to use it, how to apply it, and Oliver Wyman does have experts in that field in their consulting operations. Also, it would not have been a difficult exercise if they had been asked, and I suspect they weren't asked, but if they had been asked to look at was the ten percent return on equity still appropriate in light of financial market developments from 2005 to the present time.
(10:00 a.m.)
MR. FELTHAM:
Q. And if I just go to that under "Key Assumptions" on page nine, the bottom paragraph says "The key assumptions involve claim costs, operating costs and ROI". That's Oliver Wyman's key assumptions you refer to there, right?
DR. LAZAR:
A. Yes.

MR. FELTHAM:
Q. And "OW, Oliver Wyman, should have included ROE, but apparently they were not asked whether the ten percent after tax ROE introduced in 2005 was appropriate throughout the period 2007 to 2017." And you just referred to that. "We do examine this question for if the target ROE should have been set at a different level each year, the premium adequacy, the estimates of Oliver Wyman would be misleading." So, how so? Why might they have been misleading then? What do you mean?
DR. LAZAR:
A. I mean, if Oliver Wyman was simply presenting here are the facts over this period of time, this is what happened, without commentary whether premiums were adequate or not, whether there's overpayments or underpayments, say "here are the data; here are the facts" without commentary, I mean, I would have had no problems with it. But they then proceeded to try to estimate what the under or overpayments of insurance premiums might be

in 2017 based on the data that they used and that's where we begin to take issue.
If they're going to now look at the adequacy of premiums, then you have to start with the following: one, is the return on equity that's permitted by the Board appropriate in light of what's happened in financial markets? You know, going back 2009-2010, people have said well, the interest rate – interest rates sort of normally low. This is really an aberration. They're going to pop back up to historical levels. We've been hearing that now for nine years and it hasn't changed much. So, what's an aberration? When will interest rates return to those levels? So, one had to look at this is not a short term aberration in having historically low interest rates. This seems to have been a fundamental change. And that should then translate into what might have been appropriate return on equities, just plain common sense.
Second, expense ratio. Why use historical values? Why not look at best

practices? Look at technology and how this will affect how the insurance market should operate, could operate, and build those into the analysis.
And then return on investment, well, you look at the GISA data or MSA data and you look at the accounting data that Oliver Wyman used and you say, well, you know, the differences are too large. They should have then examined why and adjusted accordingly.
So, if they're going to use the past to try to estimate what is – you know, what's the nature of the under or overpayments of premiums going forward, then you have to address these questions and that's where Eli and I took issue with her analysis.
MR. FELTHAM:
Q. And if I can take you to page 16 of your report under 3.0. I gather this is the portion of your report where you provide some detailed consideration of what the appropriate ROE target level ought to be is where this begins I believe?
DR. LAZAR:
A. Yes.

STAMP, Q.C.:
Q. What page are you at? I'm sorry.
MR. FELTHAM:
Q. Page 16.
DR. LAZAR:
A. Yes.
MR. FELTHAM:
Q. So, firstly, I note that you refer here and you quote fairly extensively to some decisions of this Board. You refer to those. Can you take us through that a little bit and why – give us some context of why are you making those references? What does that help us understand?
DR. LAZAR:
A. As you say that this Board, like regulatory boards not only dealing with auto insurance but with other areas, electric utilities, gas utilities, et cetera, across Canada and across Canada US, have recognized increasingly, probably over the past 10-15 years, that the capital asset pricing model is the tool to use to try to determine what is an appropriate return on equity for these regulated entities. And I'm just using the

Board's decision here. So, they acknowledge that this is the case. They accept this and they believe going forward this is the model that should be used.

MR. FELTHAM:
Q. And I gather this kind of work, estimating a benchmark ROE like this, this is not the work of an actuary? It's not who typically does that?

DR. LAZAR:
A. It's finance. This is sort of the area of expertise of a Professor Prisman. I teach this as well, but it's, you know, really the workhorse of finance. Every first year finance course, this is how you determine the risk profile of companies. This is how you determine what should be their target return on equity and that's get based – built into what should be the weighted average cost of capital for companies.

MR. FELTHAM:
Q. And explain a little bit, if you could, -- and you know, I know it's pretty elementary, but the capital asset pricing model, that's what was utilized in this case to come up

with what the appropriate target or benchmark, whatever -

DR. LAZAR:
A. Yes.

MR. FELTHAM:
Q. - ROE ought to have been over time. Give us a little overview of how that works.

DR. LAZAR:
A. Essentially what you're trying to do for a company is a risk-free rate of return. That's usually taken as interest rate on some government bond. It could be short term government bond. It could be sort of a medium term government bond. But we find an asset class that we can agree the return on that asset class has little risk. Never going to be a zero risk, but it's little risk. It's almost impure risk.
Then the question becomes for a particular company. For a company's equity, for example, what should be the return? Well, the return should be over time, the company should do better than that risk-free return. If it can't be better, don't be in

business. You might as well use your capital and invest it in that government bond. So, what's the risk that the company undertakes for which it expects to be compensated and hence earn a return on its equity investment over and above that risk-free asset. So, that's the starting point.
And you then sort of look at the actual profitability of that company, relate it to the sort of return of a market portfolio. In Canada, you use the S&P TSX. If you're doing the US, probably would use the S&P.
So, you run a relationship to find out how risky is this particular company compared to the market in total and you estimate as a result what's called beta. That's an estimate of a risk profile. If this company is as risky as the market, the beta will be equal to one which means that the return on equity should be that risk-free return plus what has been the excess return of investing in a market portfolio of equities less that risk-free return. That's your premium, your risk premium. If the beta is less than one that means this

company's investment opportunities have proven to be somewhat less risky than the market in total and therefore the risk that you add to the risk-free rate will be somewhat less than for the market as a whole.

MR. FELTHAM:
Q. And I'll take you through a little bit then on the findings here, but before we get there, and I don't want to belabour this point too much, but I mean, I guess, why is it important – why is it important to know the appropriate estimated target ROE versus assuming one from 2005 is appropriate? What's the pitfalls if we use that 2005 figure? What do we run the risk of?

DR. LAZAR:
A. The pitfalls, you could both ways. Financial markets change, year to year, over time, and the risk premium that you're adding to that risk-free rate will also vary, as will the risk-free rate. So, from a regular regulatory point of view, you want to ensure that you're giving the companies the opportunity to earn what's an

appropriate return on equity for their investment class. There'll be some companies that'll do better. They're more efficient. They do better on their investment portfolio. They get lucky on their claims. Some will do poor. But what you want to do is here's the average that you're going to use for the industry. That then sets a maximum for the premiums. What the company has set, they can set lower premiums for various reasons.

If financial markets are stable, interest rates remain constant, the market's risk premium remains constant, using historically determined return on equity for regulatory purposes is fine. But since financial markets aren't stable, then it's appropriate to take these changes into account.

The work we did for FSCO, we argued there that we don't want to change return on equity year to year because you get too much variability in the markets. What you want to do, our preferred suggestion for them --

you know, we didn't have enough data here to do it for Newfoundland and Labrador, but our preferred suggestion for them was to take a ten-year rolling average. So, new year data become available. You add that into your average. You drop the data ten years ago. That gives you more stability in that return on equity over time, but it also will allow that return on equity to track what is actually happening in financial markets.

MR. FELTHAM:

Q. And at the bottom of page 18, last paragraph, there you say "As noted in Appendix 2, there are three key variables required to estimate the ROE", and I think you've gone over those, "risk-free interest rate, risk premium and an estimate of beta". And so, take us then through here the rest of your estimation process in this instance. You've identified the key variables.

DR. LAZAR:

A. Okay. So, the risk-free rate we basically used sort of the average of the expected spot rate going forward five years and we can derive that from the term structure of

interest rates. So, that's a straight forward calculation. Calculating the beta requires having data on individual companies, looking at their profitability and what we call in economics and finance, running the regression, running – using that as your dependent variable and running that against your independent variable which is simply the realized return on a market portfolio. So, you run that statistical relationship. You come up with an estimate of beta which is a measure of the risk, riskiness of this particular line of business in this province.

So again, straightforward procedure. The Excel file has the ability to do this type of statistical analysis. But what's required, again, three pieces of information. The data for companies, that's what we relied on MSA to provide us with that information. Some measure of the risk-free rate, there are different possibilities. According to Eli, the one that we use is most appropriate and most

widely used and again it's derived from Bank of Canada data. So, that's widely available. And then a market return, the TSX, the S&P TSX index with a return from year to year, again widely available. So, those data there simply run that relationship to come up with an estimate of beta that we then use to determine the return, what should be the return on equity for the individual companies and for the industry as whole.

(10:15 a.m.)

MR. FELTHAM:

Q. And, Doctor, in that regard, if we go to Table 11 on page 19, these are the results, I'll say, so you got the risk adjusted, what you've calculated the risk adjusted competitive ROEs say, ought to have been, I guess, for 2011 to 2016, and we've got numbers from a low of 5.85 up as high as 7.84—sorry, no, a low of 3.75 in 2016. I guess what strikes me about these is that none of them are 10.

DR. LAZAR:

A. And one would not expect them to be 10. At the time 10 was set, you know, interest rates were significantly higher than they are at this time, and that would account for the difference, you know, were interest rates 3 or 4 percentage points higher, that's all that would be required to get to your 10 number. Most likely, they were. The other factor, I think, was the beta that was used was 1, ours was about .8, .83, so that would tend to move the return on equity somewhat lower, but the key driver was that risk-free rate.

MR. FELTHAM:
Q. And so, I'm trying to explain this in a simple manner, I guess, or summarize this in a simple manner, but instead of utilizing a 10 percent figure, as a ROE in these years, if we were looking at premium sufficiency relative to rate inadequacies, instead of using 10, you would say we should be using these numbers?

DR. LAZAR:
A. Again, subject to the proviso I said before, that our preference would have been if you had historical data, do 10-year rolling

averages.

MR. FELTHAM:
Q. Right.

DR. LAZAR:
A. When we did the work for FSCO, we had data going back to about 1993, '94 so we could do that. That's not the case here, but if you take just a five-year average, six-year average, six percent, that would have been much more appropriate than a 10 percent number, that would be your starting point.

MR. FELTHAM:
Q. And if we go to the next page, page 20. And here this gets into the return on investment portion and I'll start at the top, you say, "The comparisons in Table 9"—which is, just for reference purposes, is back on page 15, you say, "The comparisons in Table 9 make it clear that Oliver Wyman's assumptions for ROI", return on investment, "are unrealistically low." And I guess I'm trying to break this down as much as I can. Why is the ROI important?

DR. LAZAR:
A. Again, that enters into trying to estimate

the profitability of these companies and it would factor into the rate setting process, again, familiar with what happens in Ontario and their ROI is a key variable in that rate determination process.

MR. FELTHAM:
Q. And why do you say Oliver Wyman's assumption on it were unrealistically low?

DR. LAZAR:
A. Again, you know, we derive the ROIs from the GISA data, sort of at the aggregate industry level, and the reported returns on equity for the companies and we use equity as a proxy for sort of the reserves they had available. The reason we made that assumption, and that was the assumption built into FSCO's rate determination process, so we just sort of extrapolated it to the case in Newfoundland and Labrador, and the numbers generated from those aggregate data were well above the Oliver Wyman data. I think the difference and again, I haven't done any sort of detailed analysis, is that Oliver Wyman is using as returns dividends and interest cash

received. At the GISA data level, what's included there are capital gains and losses recorded from year to year. Mostly likely because that's required for tax purposes, and there is trading in these assets that's not a matter of they'll buy an asset and stick with it. And the gap tends to reflect the fact that most, if not all insurance companies, invest a significant part of that portfolio in equities and they do so because of the higher expected returns on equity over time and the capital gains to be received, that's why that earlier table looked at the returns on the market portfolio to look at how that's bounced around and the importance of that for the ROI calculations.

MR. FELTHAM:
A. And below this paragraph at the top of page 20, there are some more references, quotes from the Board's 2005 benchmark decision and I want to refer you to the sort of second paragraph, it begins with "The Board agrees with the evidence of Dr. Kalymond and Ms. McShane"—I gather they were experts

testifying in that hearing at the time. "The 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." So I gather you've directed us to that because that's what that is telling us, it's the same thing. This is the manner in which you should—you should actually look at actual investment practices.

DR. LAZAR:

A. Yes, I mean that's what is built into the GISA data and you would expect the return on investments to track the ROEs and the gaps, don't know how small or large they might be, but again if you think of it logically, you're an insurance business and you're investing a certain amount of equity, there are going to be regulatory tax reasons for doing so, and you're going to expect a certain return on this investment. And a significant return is going to be generated by the cash you have available for a period of time and it appears, according to Oliver

Wyman the cash generated by the premiums available for about 2.3 years on average, so you're going to invest that to generate a return to boost your profitability, which says that you can run this business and your underwriting profits might be zero or close to zero and it's still profitable because you got that cash that you can invest. Well if you're simply breaking even on the underwriting side and you have a target ROE of 10 percent, you're going to expect to do 10 percent or better on your investment portfolio. You will tolerate a slightly lower return on the investment portfolio if you're actually operating with some underwriting profit. So that would boost your overall return on equity.

MR. FELTHAM:

Q. And, Doctor, staying on this page for a moment, a little further down in the third paragraph, there's the third sentence, "In Ontario, the regulator, FSCO, has been using an ROI assumption of 6 percent to set premiums." So I want to ask you about that, Mr. Stamp, counsel for the IBC, was asking

Paula Elliott, who was here on behalf of Oliver Wyman, the actuary, he asked her about that and both seemed to take issue with the notion of 6 percent being used by FSCO. Can you explain that? I mean, how did that get in there?

DR. LAZAR:

A. That was the number given to Eli and myself by FSCO when we did the original work, what, I think 2013? So it's not a number that we made up, it was a number they gave us, they showed us how they incorporated into the formula. When I did the first update for the Ontario Trial Lawyers in, I think 2016, I'm trying to remember the time period again, I went back to some contacts at FSCO and asked them what ROI are you using now? And they informed me that it was still 6 percent, so again, it's a number that came directly from FSCO. I'm not aware of their publishing it anywhere, but that's the number they used in the rate determination process, that's the number they gave Eli and me when we did the work, that's the number they gave to me in 2016. Has it changed in

the past year or two? Possibly, maybe, I don't know, but up to 2016 that was the number.

MR. FELTHAM:

Q. Okay. And then carrying on down the page, the next section in the report is "General Operating Expenses of the Insurers". I'd like to get into that a little bit. What was your assessment here of the operating expenses and what were your findings?

DR. LAZAR:

A. Those are two issues. One, from a regulatory point of view what you want to do is create incentives for companies to be efficient. If you set an industry average and you're going to base that average on one, if not two factors. One, what are the best practices in this industry, whether it's across Canada, whether it's across Canada and the US. Do the investigation, find out who is doing the best, what is the most efficient cost structure, and then you can probably say, well, okay, you'd like all insurance companies to trend towards that, but you'll set an operating expense ratio slightly above it, which will tend to be lower than what's currently in practice. And that was an argument we also made with FSCO, they had used 25 percent for a long period of time and we asked them have you actually explored those practices? And they said, yeah, we know there are companies that do much better than that, but we haven't changed it. So that's the first, you know, you want to lower this to provide incentive to become more efficient and those that are extremely efficient will have a higher ROE, those that are less efficient, a lower ROE, but that's what you want to do. The second is take into account technology. What I've read in the Oliver Wyman report, commissions are 12 percent, I look at the technology in this industry and say, going forward, commissions are going to be driven down towards zero. The technology exists today and it's only a matter of time until they essentially disrupt the current brokerage system for better, for worse. All of this can be done on-line, the information is available. We see a number of US companies

doing this, we even begin to see some Canadian companies, say you want a comparison of rates, that's easy to do. If you look at automobile insurance, it's largely a commodity. The only differences are really on the service side and from a consumer point of view how quickly, thoroughly, does an insurance company deal with a claim and individuals might pay a premium for better service; otherwise, the basic insurance policy, a commodity. So from an expense point of view what are the best practices, so let's adopt an expense ratio slightly above it and try to reduce it over time to encourage companies to become more efficient; and second, let's take into account the role of technology, how that will impact costs.

MR. FELTHAM:

Q. And I'll say this, I gather, at least in this province, a lot of insurance companies have got into the business of buying brokerages, so they may not want the commission to trend towards zero.

DR. LAZAR:

A. Yeah, but again, we have sort of a history of companies and industries that are overtaken by technology and, you know, it's one thing if that technology did not exist, was not developed, but it's quite a simple matter to do a quick cost comparison of insurance and it's a simple matter for, you know, an uber type, amazon type platform to be created for consumers to be matched up with the lowest cost suppliers, taking into account that service element.

(10:30 a.m.)

MR. FELTHAM:

Q. And, Dr. Lazar, just to wrap up on the Oliver Wyman examination, on page 22, this is your conclusion in this area and you note here four times that you say lead to Oliver Wyman reaching a conclusion of premium inadequacy. You say, "Oliver Wyman's estimates of the supposed inadequacy of the premiums for auto insurance resulted from the following key assumptions: excessive ROE of 10 percent"—and we've talked about that, but it's not been calculated, it's just assumed from 2005—"unrealistically low

pre-tax investment income returns", you've talked about that, but using investment income returns and their calculations that you say are too low, "the claims ratio being out of line with the GISA estimate", and finally, "the operating expenses being in the 25 percent range", rather than being more competitively placed, I guess. And then, so what did those assumptions lead to on the part of Oliver Wyman? What was the outcome as a result of those things?

DR. LAZAR:

A. Well, again, given the assumptions they made that would sort of bias sort of their premium as they estimated a premium, underpayments, you know, bias results in that direction, bias re: their estimated return on equities, again, towards a negative number. You know, I did some simple calculations using basically, okay, here's how we measure profits, return and equity, what are the implications? So if you were to set premiums related to the claims expected in the following year, how much higher, you know, how much higher should the premiums be over those expected claims? And it varies considerably, depending on the assumptions, and I use some assumptions with regards to the expense ratio, return on investment, return on equity, and what you get is premiums should be anywhere from the low end assumptions, about 23 percent above the expected claims for the year, upwards to, I think 42 percent higher. So depending on the sets of assumptions, how you set the premiums, there's a substantial differential. So if you use more realistic assumptions, premiums are going to be set at a much lower ratio to claims expected than if you use the type of assumptions that Oliver Wyman used.

MR. FELTHAM:
Q. Thank you, Doctor. I don't have any additional questions and concludes the presentation portion, Madam Chair, and, Doctor, there may be some questions for you from other parties.
DR. LAZAR:
A. Pleasure to entertain them.
O'FLAHERTY, Q.C.:

Q. Madam Chair, Mr. Gittens advised me that he would have to leave at 10:00, so he won't be asking any questions of Dr. Lazar.
CHAIR:
Q. Okay. That's fine, thank you. Mr. Fraize, I guess.
FRAIZE, Q.C.:
Q. We have no questions.
CHAIR:
Q. Okay. Mr. Stamp.
STAMP, Q.C.:
Q. Dr. Lazar, just to clarify, can you tell me when you were engaged for this work, please?
DR. LAZAR:
A. Well the exact date?
STAMP, Q.C.:
Q. If you have that.
DR. LAZAR:
A. Well if you bear with me, I'll open up this file and try to get some sense of this. It appears sometime June—May of 2017.
STAMP, Q.C.:
Q. Did you say June or May of 2017?
DR. LAZAR:
A. It appears to be based on this file, May,

June of 2017.
STAMP, Q.C.:
Q. And how were you contacted?
DR. LAZAR:
A. I'm sorry, you will have to speak a little louder.
STAMP, Q.C.:
Q. How were you contacted?
DR. LAZAR:
A. I don't think it was Colin's, Colin's colleague contacted I think Eli Prisman initially and asked if he was interested in sort of trying the work that he and I had done for FSCO and the Ontario Trial Lawyers Associate to explore, to examine the case in Newfoundland and Labrador.
STAMP, Q.C.:
Q. Okay, and when did you actually become engaged to do that very thing?
DR. LAZAR:
A. I think it was I that period, May, June.
STAMP, Q.C.:
Q. So you began to do—the paper we're looking at here is dated July 2018?
DR. LAZAR:

A. Yes.
STAMP, Q.C.:
Q. Are you saying you spent more than a year doing that?
DR. LAZAR:
A. No. The original report was essentially what would have been Sections 3 and 4, whatever, and in this current report, let me just go back and be exact, my conclusions, referred to as Sections 2, 3, and 4 and then Oliver Wyman's report was made public and we were re-approached to examine that report and make comments on that. So the report you have is essentially our original report, including the section of our commentary on the Oliver Wyman report.
STAMP, Q.C.:
Q. All right, so when you say Sections, 2, 3, 4, I'm just trying to make sure I'm clear, what are Sections 2, 3, 4 in this report?
DR. LAZAR:
A. Yeah, here it's just looking at the ROEs for auto insurance companies in the province, looking at –
STAMP, Q.C.:

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Q. What page is that at, Mr. Lazar, please, I'm just trying to make sure I'm clear.
DR. LAZAR:
A. Sorry, it would be—so the original report focussed on looking at the ROEs for automobile insurance companies operating in Newfoundland and Labrador, determining the appropriate return on equities, looking at the question of premium overpayments and capital adequacy. So our original report dealt strictly with those issues. Obviously the Oliver Wyman report was not available at that time and our report did not include any commentary, any discussion about the Oliver Wyman report.
STAMP, Q.C.:
Q. So what was the date of that first report?
DR. LAZAR:
A. I'm sorry?
STAMP, Q.C.:
Q. What was the date of the first report?
DR. LAZAR:
A. Again, let me go back. First report, it would look sometime, sort of mid July 2017. It appears to be the case, yes.

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STAMP, Q.C.:
Q. And that was a former report, like this one submitted to Mr. Feltham or to who?
DR. LAZAR:
A. I think Colin was our liaison at the time and I apologize, I forget the name of your colleague, and it was submitted to them and we said thank you. And then many months later, they came back to us, I guess because these hearings were announced and there was the Oliver Wyman report.
STAMP, Q.C.:
Q. So this first report you prepared was, you think, submitted, dated and submitted in around July, 2017?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And one of the focusses was ROE, you say?
DR. LAZAR:
A. It was essentially everything in this report except a discussion, commentary on the Oliver Wyman report.
STAMP, Q.C.:
Q. And in that report, particularly the ROE

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issue, was that Mr. Prisman's work essentially?
DR. LAZAR:
A. Sorry?
STAMP, Q.C.:
Q. Was the ROE essentially Mr. Prisman's?
DR. LAZAR:
A. Again, Eli did sort of the statistical of calculations. I'm fully capable of doing that, but you know, he assisted in doing it, so I had no difficulty, and then the writing of the report, based on those results, was a joint effort.
STAMP, Q.C.:
Q. You said in your evidence earlier, "estimating ROE is Prisman's, is a workhorse of finance."
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. So Prisman did that work?
DR. LAZAR:
A. He calculated the beta I the capital asset pricing model and the risk-free rates.
STAMP, Q.C.:

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Q. Okay, that wasn't your work, that was his work?
DR. LAZAR:
A. Yes, but again, I'm fully capable of doing that, it's not something that is foreign to me and it's not something I haven't used myself.
STAMP, Q.C.:
Q. Right, but you didn't do it in this case, he did it?
DR. LAZAR:
A. No.
STAMP, Q.C.:
Q. So then when were you contacted—you did that report in July of 2017, submitted it to either Mr. Feltham or one of his colleagues, and then what happened after that?
DR. LAZAR:
A. Silence until sometime early in 2018.
STAMP, Q.C.:
Q. Right.
DR. LAZAR:
A. And again –
STAMP, Q.C.:
Q. When in 2018 would that have been, Mr.

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Lazar?
DR. LAZAR:
A. It would probably have to be, what's the date of the Oliver Wyman report? Oliver Wyman report is March 29th, so it was probably sometime in April.
STAMP, Q.C.:
Q. Okay, and so you had between April, sometime and April you were contacted, you think, do you know when that was?
DR. LAZAR:
A. When exactly in April?
STAMP, Q.C.:
Q. Yes.
DR. LAZAR:
A. I'm just going by some of these dates here, all I can say is sometime early April.
STAMP, Q.C.:
Q. And then your report is dated July, when was it actually submitted? What date in July?
DR. LAZAR:
A. The report, I think early July, July 12th thereabouts, again just going by the dates that I have here.
STAMP, Q.C.:

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Q. So should I take it from this that you spent about three months doing the report?
DR. LAZAR:
A. No.
STAMP, Q.C.:
Q. Okay, how long?
DR. LAZAR:
A. How long? It was over that period of time, but I don't know the exact number of days. Five days, eight days, over that period of time, somewhere in that range.
STAMP, Q.C.:
Q. All right. In your report you suggest that, and I'm not sure if I—I will try and locate the exact—in your report and you spoke about this this morning, you estimated premium overpayment and you referred to the 92, 54 to 92 you said was the upper limit?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. 54 to 92 as an upper limit. Why is there such a significant range in the upper limit?
DR. LAZAR:
A. It's a function of what companies were

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included for the calculation and the differences were for the higher limit we excluded, not only the TD subsidiaries, but I think there were three other companies that were excluded, personal insurance, I think Intact and there was there another one? I believe that's it, yes.
STAMP, Q.C.:
Q. And if you looked at the upper limit, what was the lower limit?
DR. LAZAR:
A. The lower limit –
STAMP, Q.C.:
Q. For comparison to 54 to 91 being the upper limit, what would be the lower limit?
DR. LAZAR:
A. The lower limit would be from zero upwards, the only way we could ever determine the actual number, as I said before, is if we knew what the premiums that were permissible aggregated overall companies were in each year, and what the premiums could have been using different sets of assumptions.
STAMP, Q.C.:
Q. On that very point that premiums that are

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permitted each year, did you make any inquiry of the Public Utilities Board to determine what premiums were permitted?
DR. LAZAR:
A. No.
STAMP, Q.C.:
Q. Why didn't you do that?
DR. LAZAR:
A. Just using public data, we weren't going into any sort of detailed analysis. Our original, sort of, position was to look at the return on equity, what should it have been. A second was to look at the reasonableness of the expense ratios.
STAMP, Q.C.:
Q. Yes, I know, I got that.
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. I heard that. I'm trying to understand why you didn't look at available data the Public Utilities –
DR. LAZAR:
A. Okay, I -
STAMP, Q.C.:

Q. - Board has all the rates available that are approved for insurers, you didn't choose to look at that?
DR. LAZAR:
A. No, because again, we were studying from a different, not mandate, but a different sort of approach. Even if we had looked at it, we would then still have had to go back to the regulator and say, okay now for each of these insurance companies tell us what were their expected claims year by year. And then we could come up with an estimate of what would be more reasonable permitted premiums. That, I think, is a task for the Board to do or to decide whether they want that done to come up with an accurate measure.
(10:45 a.m.)
STAMP, Q.C.:
Q. You talked about companies shifting income –
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. to the most favourable location. If companies have an obligation to pay taxes in

this jurisdiction, for example, that's a legal obligation, is it not?
DR. LAZAR:
A. That's legal, but you still have flexibility with regards to how you allocate expenditures.
STAMP, Q.C.:
Q. So, you're not asserting that somebody has, sort of, cheated one province or another.
DR. LAZAR:
A. I made it clear at the outset that transfer pricing is legal. There are limitations imposed and companies would fully take advantage of the rules to minimize their tax liabilities. They're not doing anything illegal. It's all legal; it's all permissible.
STAMP, Q.C.:
Q. Okay. I want to come back to your table 17, it's at page 29 of your report.
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. So, do I understand that's what's happened here is that you took certain companies in

the top line and more companies in the bottom line, is your—if what is done here is added 15 and 9 and 3 and 26?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. To 54?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And added 42 and 19 and 6 and 24 to 92?
DR. LAZAR:
A. Correct.
STAMP, Q.C.:
Q. Right. Now, you also said—I just want to try and find this for you. I can't put my fingers right on it, but my recollection, Mr. Lazar, was that you said, there were significant losses in '14 and '15.
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. I think you said the profits—when profits eroded substantially, I think you might have said, in '14/'15.

DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. Were the profits in '14/'15 that would go into Table 17 negative?
DR. LAZAR:
A. They weren't included in Table 17.
STAMP, Q.C.:
Q. No, that's what I'm wondering; where are they?
DR. LAZAR:
A. I just ignored them. I was asked to redo this, taking those into account.
STAMP, Q.C.:
Q. Taking, asked to take what into account?
DR. LAZAR:
A. The negative results in 2014/2015 and if they're negative results, the argument that was posed to me was well, does that mean that there were premium underpayment and shouldn't that be factored out? That was the presumption and I reported to that question and said okay, I'm quite happy to throw them in here are the results.
STAMP, Q.C.:

Q. Okay, I'm confused. We got to back up a bit. You said somebody asked you to take them out?

DR. LAZAR:

A. No, no. Someone asked, posed a question to Eli and myself, okay, you didn't include those negative results. Shouldn't you have included them to refine your estimates of the upper limit of the premium overpayments assuming that if there were these losses that therefore there were premium underpayments and that should have been deducted from the premium overpayments to come up with a more reasonable number? That question was posed to us and we responded and said, that's fine, we'll throw these in and we'll show you what the numbers are and you can judge what that means for you, but I'll have a different position on that.

STAMP, Q.C.:

Q. Where are those numbers thrown in?

DR. LAZAR:

A. In a response to questions submitted by the Public Utilities Board, I'm not sure if it was the Board that asked that question or if

it was your organization that asked the question. We responded and submitted those to Colin and I just presumed that he forwarded them to everybody who is participating here.

STAMP, Q.C.:

Q. Sure, and so for '14/'15, if you have plugged in numbers in both lines, all excluding Primmum and Security National –

DR. LAZAR:

A. Yeah.

STAMP, Q.C.:

Q. - and then the second line, all positive ROEs, if you'd plug numbers in there for those two years, for those two groupings, what would the numbers be?

DR. LAZAR:

A. The resulting total over the period?

STAMP, Q.C.:

Q. No, the numbers for '14 and the numbers for '15.

DR. LAZAR:

A. Okay. Roughly, again slightly different methodology, but the numbers will be reasonable, -21,000,000 by both years and

one can then –

STAMP, Q.C.:

Q. Negative twenty one million?

DR. LAZAR:

A. Negative twenty one million.

STAMP, Q.C.:

Q. In which line?

DR. LAZAR:

A. 2014/2015.

STAMP, Q.C.:

Q. Which line of 2014/'15?

DR. LAZAR:

A. All excluding Primmum and Security National.

STAMP, Q.C.:

Q. Twenty one, twenty one million?

DR. LAZAR:

A. Yes.

STAMP, Q.C.:

Q. Negative?

DR. LAZAR:

A. Yes. And then the question becomes, does this reflect premium underpayments?

STAMP, Q.C.:

Q. Well, it affects a poor result in '11, '12, '13 and '16, does it not?

DR. LAZAR:

A. Yes, however, as I pointed out, the complete analysis would have been here are the premiums and aggregate that were permitted. Here are the premiums that should or could have been permitted under different set of assumptions. ROE assumptions, expense assumptions, ROI assumptions. And you take that differential which means in 2014/2105 it still would have been a positive number.

STAMP, Q.C.:

Q. Hold on a second now. When you did 2011, did you use a number that actually occurred, you say –

DR. LAZAR:

A. Yes.

STAMP, Q.C.:

Q. - a number that—is it a number that you created or that's published somewhere?

DR. LAZAR:

A. That number, that's a number we created. We took the actual performance and we compared it to what would have been a more appropriate ROE for that year.

STAMP, Q.C.:

Q. Right, okay, so you took your theory of what's more appropriate and generated a number for 2011 of 15.4, is that right?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And you did the same for '12 and so on?
DR. LAZAR:
A. Correct.
STAMP, Q.C.:
Q. And when you took your appropriate approach on '14, what did you get?
DR. LAZAR:
A. When you're referring to appropriate approach –
STAMP, Q.C.:
Q. No, I don't think it's appropriate. I'm saying it's your approach.
DR. LAZAR:
A. Okay, which one are you referring to?
STAMP, Q.C.:
Q. The one that gave you 15.4.
DR. LAZAR:
A. For that, again since the gap was negative, we just zeroed it out.

STAMP, Q.C.:
Q. Hold on now. You used an approach you told me.
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. I want to understand this. You used an approach to get 15.4.
DR. LAZAR:
A. Okay, let me backtrack.
STAMP, Q.C.:
Q. Sure.
DR. LAZAR:
A. When the gap between the actual ROE and our estimate of what would be an appropriate ROE, again subject to the fact that we're using annual numbers rather than a moving average, when the gap was positive, that produced an estimate of an upper range for possible premium overpayments. When the gap was negative, which was the case in 2014/2015, we just zeroed it out. We did not include that.
STAMP, Q.C.:
Q. But why did you zero it out? Why not show

what your similar approach would have been for '14 rather than leave it blank?
DR. LAZAR:
A. Because our arguments would be that the losses that were incurred might have been the result of misestimating, misjudging the actual realized claims for the year, might have been the result of competitive pricing. There may have been a whole host of other factors that drove those losses. These are ex-post losses compared to what was anticipated at the beginning of that period.
STAMP, Q.C.:
Q. But everybody anticipates at the start of the period, I guess, that they're going to make some money.
DR. LAZAR:
A. Yes, that's the essence of risk.
STAMP, Q.C.:
Q. Sure. But I got to tell you, Mr. Lazar, you got me baffled because I'm looking at this and saying, okay, you leave out some years because it could be explained by some bit of back luck and planets lined up badly. This is what would have happened, but you don't

tell me the numbers.
DR. LAZAR:
A. We did present the numbers in response to the question.
STAMP, Q.C.:
Q. Can I ask you to take a look at your, I guess these came from you, responses to questions submitted by Public Utilities Board.
DR. LAZAR:
A. Yes. The numbers are there.
STAMP, Q.C.:
Q. Okay. Do you have that? I don't know if you have that up there.
DR. LAZAR:
A. I have it.
STAMP, Q.C.:
Q. Thank you, okay. So, tell me, the question I guess—I can probably get the questions for you too so that we won't be confused, just give me a second there.
DR. LAZAR:
A. What you're suggesting is, if we throw those in, that gives a better estimate, possibly of premium overpayments over the entire

period.
STAMP, Q.C.:
Q. Mr. Lazar, the Public Utilities Board question number 6 was this, "Please explain why the years 2014 and 2015 are left blank in Table 16, 17 and '18"? And your answer which was on the board a moment ago—I'm sorry we just shifted off that again, but your answer was there.
DR. LAZAR:
A. Because the gap was negative.
STAMP, Q.C.:
Q. Yeah, your answer--sorry, just to come back to your answer--is "the years 2014 and '15 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". So, where are the numbers? You said you gave the numbers, where are the numbers?
DR. LAZAR:
A. They're in point 7 on that same document.
STAMP, Q.C.:
Q. Is that "ROE gaps" that you're talking

about?
DR. LAZAR:
A. Yes, yes.
STAMP, Q.C.:
Q. So, when you said 21,000,000 –
DR. LAZAR:
A. That's point 8.
STAMP, Q.C.:
Q. Hold on now, I'm trying to understand.
DR. LAZAR:
A. I thought it was clear in what we did and how we responded.
STAMP, Q.C.:
Q. Not to me.
DR. LAZAR:
A. Sorry.
KENNEDY, Q.C.:
Q. I think it should be pointed out, Chair, and it will be pointed out to members of the Board later, Mr. Stamp has had this report, IBC has had this report for quite some time. They could have had their own expert, they could have brought expert evidence. I don't' think the commentary, the gratuitous commentary "it's not clear to me" adds

anything to this hearing. Comments like that—Dr. Lazar is answering the questions, the questions are being put to him. They could have had their own expert and we will be arguing this in our submissions.
STAMP, Q.C.:
Q. The point, Madam Chair, of course is Mr. Lazar has prepared this report, we're looking for clarification, that's the purpose of the questions, to inform the Board on Mr. Lazar's report and any questions that arise out of that report. We've done the same thing. I mean, all the questions that were put to Oliver Wyman, there were tonnes of questions of the same sort, explain this and explain that. There's nothing different happening here at all with Mr. Lazar and I'm just trying to understand it.
DR. LAZAR:
A. Oh no, I have no problem with your questions.
KENNEDY, Q.C.:
Q. It's the gratuitous comments that I have—the commentary "I don't understand", "I'm not

clear", that's not the purpose of questioning, ask a question and you'll get an answer, can you explain a little bit further" but we've seen this now for two days with gratuitous comments that I would suggest, sir, is not appropriate. It's not the way it should be conducted, the questions should be conducted. It's disparaging to the witness, "I'm not clear", "I don't understand".
STAMP, Q.C.:
Q. And I don't.
KENNEDY, Q.C.:
Q. Well that's your problem, Mr. Stamp. You could have obtained an expert witness, you chose not to do that, you choose to rely on Oliver Wyman, fair enough, that's the way this works out. So I'm suggesting, Madam Chair, we saw it yesterday with the attack on the people from Ontario and I don't think this thing can deteriorate to that same kind of questioning today, that's what I'm asking you to stop.
STAMP, Q.C.:
Q. Madam Chair, Mr. Lazar was asked about the

gap in his Table No. 17, and he's explained in some fashion why that gap exists. He said he provided the numbers in answers to either IBC or the Public Utilities Board. So I got the questions and I've read the question into the record from the Public Utilities Board, Question No. 6, and I've asked—because the answer to Question No. 6 is contained in the Answer No. 6 in the response, but the numbers that were asked for by the Public Utilities Board are not given in No. 6. Now I think Mr. Lazar had explained to us they're in maybe 7 or 8, I'm going to just try and clarify that because that's where my confusion lies.

CHAIR:
Q. Just ask your question.

STAMP, Q.C.:
Q. Sure. So, are the numbers for 14 and 15, Mr. Lazar, that would have gone into Table 17, which were asked for by the Public Utilities Board, where are they please?

DR. LAZAR:
A. They're in Point 9.

STAMP, Q.C.:

Q. And they're percentages, are they?

DR. LAZAR:
A. Sorry?

STAMP, Q.C.:
Q. Are Point 9 percentages?

DR. LAZAR:
A. Oh, sorry, Point 8.

STAMP, Q.C.:
Q. Point 8 has the numbers?

DR. LAZAR:
A. Yes, sorry about that.

STAMP, Q.C.:
Q. Okay, so Point 8 is dollar amounts?

DR. LAZAR:
A. Yes. Point 9 is percentage amounts, as you correctly pointed out.

STAMP, Q.C.:
Q. Right, and so the 14 number is minus 29 million now?

DR. LAZAR:
A. No, the one that is comparable to Table 17 in our report is 21 million, minus 21 million number.

STAMP, Q.C.:
Q. I thought—and you can clarify this for me,

when I was asking what numbers would have gone into the lines on 14 and 15 of Table 17, I thought you had told me the top line?

DR. LAZAR:
A. No, it's again to be equivalent the first, well the second row there is all excluding Primmum and Security National. This is where the minus 21 million comes in.

STAMP, Q.C.:
Q. Okay.

DR. LAZAR:
A. Second is all positive ROEs where it's approximately minus 20 million.

STAMP, Q.C.:
Q. So if you included those minus, for example all companies is minus 61 million.

DR. LAZAR:
A. Okay, now I want to point out that in responding we did just a short cut, just took the gap, multiplied it by the equity. For the report, we did an iterative process, the only reason we did the short cut here was just time constraints. If you compare the results in the response Point 8 to our Table 17, what you find is the iterative

process actually produced larger estimates of the overpayments.

STAMP, Q.C.:
Q. So when I look at your answer No. 8.

DR. LAZAR:
A. Yes.

STAMP, Q.C.:
Q. Looked at the question, but the answer, because this is what you're explaining to me, is that the total 11 through 16, all excluding Primmum and National Security and all companies, it's just that those two—the two things are flipped around from the Table 17. Table 17 has all positive ROEs on the bottom and you have all companies on the top in this table at No. 8, is that right?

DR. LAZAR:
A. Is that first row, all companies, is nowhere in Table 17.

STAMP, Q.C.:
Q. Okay.

DR. LAZAR:
A. Only the next two rows are the equivalent to what's in Table 17.

STAMP, Q.C.:

Q. Which two rows, I'm sorry?
DR. LAZAR:
A. The last two rows. Would it be easier if I just came there and pointed it out? I mean, I'm sorry, I just can't make it any clearer. I'm not sure what the confusion is.
STAMP, Q.C.:
Q. Well when I look at Table 17, all positive ROEs.
DR. LAZAR:
A. Yes. That is the equivalent of the last row in our Point 8.
STAMP, Q.C.:
Q. Right, which is 92 million, the total 92 million?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And that becomes 2 million?
DR. LAZAR:
A. No, it becomes 35.
STAMP, Q.C.:
Q. I'm sorry, in –
DR. LAZAR:
A. You have got to compare the same groupings.

STAMP, Q.C.:
Q. Where do I find 35 in the—Oh, over here, over in the other positive ROEs.
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. I see. Okay, so there's all companies and all positive ROEs.
DR. LAZAR:
A. And the number in Point 8, the 35 million, if we had used the same methodology we used in the report, that number would actually be higher, approximately about 15 – 20 percent higher.
STAMP, Q.C.:
Q. So, this in this response you gave to the Public Utilities Board, the 54 million in Table 17 becomes two in estimated, in Number 8 answer.
DR. LAZAR:
A. Yes, but again –
STAMP, Q.C.:
Q. And the 92 becomes 34.
DR. LAZAR:
A. But both of those are underestimated

because we use a simple methodology for the responses as compared to the more appropriate iterative methodology in our report.
CHAIR:
Q. Mr. Stamp, might this be a good time for us to take a break?
STAMP, Q.C.:
Q. Yes, Madam Chair.
(BREAK – 11:06 a.m.)
(RESUME – 11:36 a.m.)
CHAIR:
Q. Back to you, Mr. Stamp.
STAMP, Q.C.:
Q. Thank you, Madam Chair. Mr. Lazar, I'm just going to go back to your Table 17 in your report for a moment, at page 29.
DR. LAZAR:
A. Okay.
STAMP, Q.C.:
Q. I want to note for a moment, the top line "All except"—I guess—"Primmum and Security National", do you see 15.4, 9.5, 3.4 and then two spaces and the 26 and 54. And if I can now turn to the answers or responses to

the questions from Public Utilities Board and at page, there's no page number, I'm sorry, answer Number 8, I guess, at the bottom of the page. Yeah, that's right there, that's fine. Do you have that Mr. Lazar?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. Now, you don't have the other numbers in front of you again, but if you need, I can –
DR. LAZAR:
A. Which table were you –
STAMP, Q.C.:
Q. The bottom of—it's marked Number 8.
DR. LAZAR:
A. No, no, what was the table in the report you referred to?
STAMP, Q.C.:
Q. Seventeen.
DR. LAZAR:
A. Okay, I've got that here.
STAMP, Q.C.:
Q. So, what I'm noting is that the line for "all excluding Primmum and Security

National" in the table, in response Number 8 puts numbers in there, of course, 21 million or -20.7 or whatever, -20.7 and 20.7.

DR. LAZAR:
A. Yes.

STAMP, Q.C.:
Q. But why have you changed the other numbers as well?

DR. LAZAR:
A. Okay, as I explained, there are two possible approaches. The simple approach which is what was used for Point 8 here in the response was to simply take the gap, the difference between the actual ROE and/or estimate of what should be an acceptable ROE and multiply that times the total equity. So, that's the methodology, the simple methodology that we employed in the response, less time consuming.

STAMP, Q.C.:
Q. Okay.

DR. LAZAR:
A. In the report, we went through an iterative process because once you start making adjustments for differences in equity, you

have to factor that back into return on investment, et cetera. So, we use the more, sort of, complicated with more appropriate approach in the report than we did in the response. And again, the only reason we did that for the response was to save time.

STAMP, Q.C.:
Q. Okay. I want to just come back to your evidence earlier today. At one point you said, and hopefully I got this generally accurately recorded, reserves are invested by insurers and it's a major driver of profitability. Now, I may not have that exactly right, but something to that effect.

DR. LAZAR:
A. Yes.

STAMP, Q.C.:
Q. And what are reserves?

DR. LAZAR:
A. The reserves that have to hold against future claims.

STAMP, Q.C.:
Q. And so is that—that's not the premium for investment, is it?

DR. LAZAR:

A. No, the premium is part of the—two parts of it. I believe there's legal obligation to hold a certain amount of reserves against future claims. And the premiums provide the claims will be paid in the future. You going to have net of your expenses some cash available to you for a period of time that you can that you can invest.

STAMP, Q.C.:
Q. So, reserves for the purposes of this, when you made this comment, reserves are essentially equity that's maintained in the company?

DR. LAZAR:
A. We equated it to primarily because of the work we did with FSCO where they simply used the particular ratio of premium to equity which FSCO claimed and we have no reason to question them on this, they said was a measure of, sort of, the reserves, the investable funds that the companies had.

STAMP, Q.C.:
Q. But when I asked you what reserves were, I thought you said it's the amount retained to provide protection for claims. Did you say

that –

DR. LAZAR:
A. For future claims, yes.

STAMP, Q.C.:
Q. Future claims, yes. And so that's the—is it essentially the equity in the company?

DR. LAZAR:
A. We use them as being equivalent.

STAMP, Q.C.:
Q. That may be, but essentially is what you're referring to, essentially is the equity in the company.

DR. LAZAR:
A. The equity committed for this line of business.

STAMP, Q.C.:
Q. Right. And would that be all the equity in the company or limited amount of equity?

DR. LAZAR:
A. Again, we used it as the entire equity committed to this line of business in this province.

STAMP, Q.C.:
Q. Okay. Now, you also spoke about reserves, I think, in a different context. You said,

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most if not all insurers invest significant part of reserves in equity. Do you recall that discussion?

DR. LAZAR:
A. Yes.

STAMP, Q.C.:
Q. And so when you speak that way, are you speaking about the same reserves that you spoke about earlier?

DR. LAZAR:
A. Yes.

STAMP, Q.C.:
Q. Okay. And what part, you say a significant part, what part does each insurer invest?

DR. LAZAR:
A. I don't know.

STAMP, Q.C.:
Q. But you said it was significant.

DR. LAZAR:
A. If you'll look at the returns they've generated on their investments and essentially on this pool of funds, then you know, you compare it to returns on investing in a bond portfolio, one can infer from that as we did, that there has to be, don't know

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what the number is, 40, 50 percent on average that might be invested in equities in order to generate those returns.

STAMP, Q.C.:
Q. I just noticed that one of the pieces of information that IBC has on their—they have a facts book which records or discloses how insurers, P & C insurers invest—how they actually—what they invest in. And the investment on the equity side, this is I think part of the data is from MSA and I think some from Provincial authorities. That investment in shares which I take it to be equities is 11.2 percent as of the end of the December 2017.

MR. FELTHAM:
Q. Madam Chair, Mr. Stamp is—we've had this theme reoccurring here. Again, we're referring to documentation which hasn't been provided to the Board, hasn't been provided to the parties, that witness has not had an opportunity to review what he's being referred to. It's very unfair.

STAMP, Q.C.:
Q. Madam Chair, let me just try and see if we

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can get past some of this complication. Mr. Lazar came this morning and he testified that more, if not all insurers invest significant part of reserves in equity. Now, I don't know where that would be in this report. I haven't seen it and so he's testified or spoken about or presented it as part of this information this morning. I'm happy to let that go in, but I'm happy to question him about it as well. I can't anticipate what he will say and come armed with a library. I had to come and listen to Mr. Lazar give his presentation and then ask him about that presentation. This is just one aspect of that presentation.

(11:45 a.m.)

MR. FELTHAM:
Q. Madam Chair, it's not library. He's the one who is bringing up the document and referring to it. It's an IBC document. It would be so difficult to provide that document in advance, if he's going to question the witness about it.

STAMP, Q.C.:
Q. Madam Chair, I didn't hear the comment until

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I heard Mr. Lazar speak. I didn't come with, you know, all the GISA and FSCO and IBC documentation in my back pocket. I can't do that. I listened to Mr. Lazar explain what he thought was the investment, I don't know, agenda or style for P&C insurers and said that a significant part and I think he went on to say, I don't know if he said 40 percent. I'm sorry, Mr. Lazar, I can't remember what you said there, significant part, 40 percent maybe I think he said and according to the IBC and information I've just been passed, it's more like 11.1 or 2 or whatever I said that percent I said was.

CHAIR:
Q. Yes, yes –

STAMP, Q.C.:
Q. So, I can't come—my friend is critical of me not coming with information. I can't come with that information. I can only try to deal with it as it arises.

CHAIR:
Q. I agree, Mr. Stamp. When information arises in the course of cross-examination I

appreciate that information is not in the report. It would be helpful to the Board though if you're referring to something that's different than what Mr. Lazar would have said to put it on the record.

STAMP, Q.C.:
Q. Madam Chair, yes, what I can do is I can tell you, if you can just—I can ask what that document actually is so Mr. Lazar can then refer to it if he wishes or –

CHAIR:
Q. Well, it's going to be difficult for him to refer to it now, so.

STAMP, Q.C.:
Q. Yes, I know. It is a –

CHAIR:
Q. Can you just make a copy of the –

STAMP, Q.C.:
Q. Well, I can send—maybe I could just send that information to maybe Ms. Glynn or somebody and it could get printed or something. Is that possible? Can you send that to—one page? Does that explain where it came from? We'll do our best, Madam Chair to –

CHAIR:
Q. Yes, well, it would have to put on the record for us to be able to take note of it in any event.

STAMP, Q.C.:
Q. That's fine, sure. We'll let that unfold and I'll come on to –

DR. LAZAR:
A. Can I just ask one thing and then you can comment? The 11 percent, that's for all P&C companies in Canada?

STAMP, Q.C.:
Q. I gather so.

DR. LAZAR:
A. And what time period?

STAMP, Q.C.:
Q. At the end of December 2017, but I don't know any –

DR. LAZAR:
A. Okay, but it could vary from year to year?

STAMP, Q.C.:
Q. Oh, I'm sure it would.

DR. LAZAR:
A. And secondly, you don't know what that number is for the auto insurance companies

that operate only in Newfoundland and Labrador.

STAMP, Q.C.:
Q. I don't think so.

DR. LAZAR:
A. Could be plus or minus for that. You don't have those data? Okay, so my, sort of, question, my comment then, if you look at my Table 14 in my report, where I compare the S&P TSX Annual Return and Net Investment Return on Equity for the Auto Insurance Companies in Labrador and Newfoundland, assuming it's 89 percent in bonds, 11 percent in equities. Now, of course the 89 percent, it could be another asset (phonetic) classes. You know, Eli and I can sort of do quick calculations what the returns on a bond portfolio would be and at 89 percent, 11 percent split, you're not going to get numbers anywhere near this. The returns on a bond portfolio were simply too low given that 89 percent weight to generate these types of returns. So, that's why when I said "significant", I'm looking at these numbers. I know what happened to

interest rates over this period of time, so there was no much capital appreciation. The yields on them are quite low and, you know, applying 89 percent to that 11 percent to the rest, you're going to get investment returns on equity that are significantly lower than these reported numbers. So, those numbers might be interesting, I would question them, and in particular how appropriate are they for the auto insurance companies operating in this province?

STAMP, Q.C.:
Q. So, on that point, Mr. Lazar, where did you get 12.12, is that your number?

DR. LAZAR:
A. No, that's from the GISA numbers.

STAMP, Q.C.:
Q. That's a GISA number?

DR. LAZAR:
A. Sorry, should be a GISA number, I believe.

STAMP, Q.C.:
Q. Can you tell me where in GISA we'll find that, please?

DR. LAZAR:
A. Okay, going back—sorry, this is not GISA,

it's from the individual insurance companies, from the MSA research base.
STAMP, Q.C.:
Q. So, this is MSA information you're saying?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. Okay. So, they've done some kind of a calculation to break down Newfoundland –
DR. LAZAR:
A. No, they've just reported, here's the net income from investment, here's the equity and we've allocated it to these companies. They didn't so these calculations. We used their numbers, simply a matter of taking a ratio between two numbers to produce these numbers.
STAMP, Q.C.:
Q. I'm going to ask if we can bring up the source of the information that I was referring to. Do you see that, Mr. Lazar, it's on the screen now?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:

Q. So this is, I take it, Canada wide, P&C?
DR. LAZAR:
A. Um-hm.
STAMP, Q.C.:
Q. I'm assuming—can we just go to the top again, please? Yes, okay, so that's the discussion. It's an IBC document. If you can just go down to the bottom, you'll see there, it's investments and I guess, it's millions of dollars I guess it is, as of December 31, 2017 and at the bottom of that, it's hard to make it out, but it looks like "as of 2016 Q4 Investments reported through OSFI regulatory returns exclude pool funds accounted using equity method, source IBC, MSA, SCOR AMF and you'll see shares are shown both as a dollar amount and as a percentage.
DR. LAZAR:
A. What's the other category?
STAMP, Q.C.:
Q. Well, it looks like mortgages.
DR. LAZAR:
A. No, no, no, the -
STAMP, Q.C.:

Q. No.
DR. LAZAR:
A. What's called "other," that 16 percent?
STAMP, Q.C.:
Q. I don't know. I don't know the answer.
DR. LAZAR:
A. Okay.
STAMP, Q.C.:
Q. Okay, in any event, apparently, it's something other than shares.
DR. LAZAR:
A. Um-hm. It could be investment in, you know, other companies that are essentially investing shares. I—again –
STAMP, Q.C.:
Q. Okay.
DR. LAZAR:
A. If I add the two together, 27 percent, it's still not, at least for these companies operating in Newfoundland and Labrador, the splits are going to be different, and remember, we weren't using 2017 data, so what were the data for 2011 to 2016?
STAMP, Q.C.:
Q. Okay. Mr. Lazar, I'm going to come back now

if I can to the early part of your report. Get myself organized. At page 5 of your report, please.
DR. LAZAR:
A. Yeah.
STAMP, Q.C.:
Q. And you get into a discussion here about the exclusion or inclusion of various companies?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And then, we go to page, I think it's 24. So, you list 15 companies right there on that chart at page 24? It's table 13.
DR. LAZAR:
A. I believe so.
STAMP, Q.C.:
Q. I just did a quick count.
DR. LAZAR:
A. It sounds right.
STAMP, Q.C.:
Q. And I'm just going to go a little further over. I think there was a further discussion on this point a little further along. Yes, at page 32, Mr. Lazar.

DR. LAZAR:
A. Um-hm.
STAMP, Q.C.:
Q. I think this is the same 15 companies, but you mention two others. Is that Tokio Marine or Tokyo Marine? How do you say that, do you know?
DR. LAZAR:
A. I would assume –
STAMP, Q.C.:
Q. Anyway, Tokio Marine.
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And Zurich are two mentioned companies. Do you see that in the paragraph below the list?
DR. LAZAR:
A. Yeah.
STAMP, Q.C.:
Q. Yes. And what you said was, “We excluded both.”
DR. LAZAR:
A. Yes.
STAMP, Q.C.:

Q. And if I’m saying it right, “Tokio Marine was a marginal player at best in the industry in the province with an average of $8,833 in written premiums during the period 2011 to 2016.”
DR. LAZAR:
A. Correct.
STAMP, Q.C.:
Q. That’s why it was excluded?
DR. LAZAR:
A. We excluded them in order to calculate the beta, so that would could calculate the return in equity.
STAMP, Q.C.:
Q. But what you say is that it appeared to me a marginal player?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. With what I take it you mean to be a small average written premium?
DR. LAZAR:
A. That’s right.
STAMP, Q.C.:
Q. Is that right?

DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And by “average written premium,” does that mean ‘11 through ’16, six years, six times, you know, eighty-eight—six times nine, $54,000 or so is what we’re talking about?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. That’s why they are a small and marginal player?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And you excluded Zurich because they only operated in ’11, ’15 and ’16?
DR. LAZAR:
A. According to the data we were given, yes.
STAMP, Q.C.:
Q. And this is MSA data in both cases?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. Okay. So, what would be—I mean, where Tokio

was excluded because, you know, $8,833 on average in 2011 through 2016, but what would be the cut-off? If they had been $20,000, would they have stayed?
DR. LAZAR:
A. That would be 20,000. Looking at what—200-plus million. Probably the cut-off would have been, figure it out, on tenth of one percent would have been reasonable.
STAMP, Q.C.:
Q. Well, how does that translate into a number, you know, per month or something or –
DR. LAZAR:
A. Roughly 200,000.
STAMP, Q.C.:
Q. Two hundred thousand.
DR. LAZAR:
A. Again –
STAMP, Q.C.:
Q. So, 8,000 is way too low for you. Two hundred thousand would have been –
DR. LAZAR:
A. Yeah, again, if you throw that in, that wouldn’t have affected our estimate of the beta.

STAMP, Q.C.:
Q. Okay.
DR. LAZAR:
A. In the case of Zurich, if you were throwing that in, that would have affected it because it was in and out, and you want consistency, you wanted companies that were in this industry throughout this period.
STAMP, Q.C.:
Q. Okay, okay. So, on that note, I want to bring up the material from the superintendent who was the regular, one of the regulators in Newfoundland, the Superintendent of Insurance. He publishes a report showing insurance premiums and claims and so on. And if we turn to that, that's been—I think it's on the system now. We've provided the table 1 chart from the Superintendent's Report from 2011 through 2016. Okay? So, if we can bring up 2011, please. And with '11 I'll turn first to ACE INA Insurance. That's the first one on the second page, the first company. This is a published document by the Public Utilities—by, I'm, sorry, by the Superintendent of

Insurance. This one is published for 2011, and if you turn to the last page, just to have the—we have that last page just to show you how it's—how they're focusing on it, there's some totals on that last page which is page 14 of this document at the bottom of the page. So, you'll see that in—under the columns for automobile insurance they have a number of categories, but total earned premiums is the middle line. And you'll see the total earned premiums in, I guess, in thousands of dollars. So, the total earned premium for liability, 245 million, plus; for personal accident, 29 million; for other, 106 million. Okay? So, that's what they—that how they do it, and then you go back to the front, to the second page of the exhibit, you'll see that they, for each company, they provide a similar breakdown, and in the second row in each case it's the total earned premium, and in the third row it's total direct claims. That's what the Superintendent reports. So, here we have ACE INA Insurance. They weren't included in your study, were they?

DR. LAZAR:
A. No, we didn't get data on that company.
STAMP, Q.C.:
Q. Okay. I can tell you that if we looked at all the charts, my understanding that they provided insurance coverage or wrote premium 2011 through 2015, but not in '16, and the total premium was about 1.7 million dollars, would that be a number that should have been included in some fashion in your analysis?
(12:00 p.m.)
DR. LAZAR:
A. You said they weren't in there in 2016?
STAMP, Q.C.:
Q. They were not there in '16.
DR. LAZAR:
A. Well, we would have excluded them because we would not have consistency.
STAMP, Q.C.:
Q. Okay.
DR. LAZAR:
A. Remember the purpose of the companies are included here were for estimating for incorporating them into the capital asset pricing model to estimate a measure of the

risk profile.
STAMP, Q.C.:
Q. Let me jump down, Mr. Lazar, to the next page, the top of the next page, Atlantic Insurance. Do you see that entry?
DR. LAZAR:
A. Um-hm.
STAMP, Q.C.:
Q. I can tell you that in this year, they have of course as you can see, 2.9 million and 98 thousand and then 994 million in coverages, but I've taken the trouble of going through the—all of these reports from '11 through '16. And Atlantic Insurance premium in 2011 was 3.9 million; 3.6 plus in 2012; 3.4 million plus in 2013; just shy of 3.5 million in 2014; just over 3 million in 2015; and 2.4 million in 2016. An approximate total of 20 million dollars in earned premium in the six-year period. Why would they be excluded?
DR. LAZAR:
A. Again, if they're not on our list, the only three we excluded were those three that we mentioned. If we didn't get data for them,

then we did not incorporate them into our analysis.

STAMP, Q.C.:

Q. Did you ask, or did you look, at the Superintendent's Reports to see what other data would be available?

DR. LAZAR:

A. No, we went strictly to MSA.

STAMP, Q.C.:

Q. So, if MSA didn't have Atlantic and you're— and you say they don't –

DR. LAZAR:

A. Right.

STAMP, Q.C.:

Q. - they missed 20 million dollars worth of premium from an insurer who wrote every year from '11 through '16?

DR. LAZAR:

A. Okay. Now, let me explain the relevance of this, if any. If we had this complete set, and we had an expanded data set, would that have produced a different estimate for beta and the risk profile? Maybe. Would the beta have been higher or lower? Don't know. Could have been lower which would have meant

the return equity according to the capital asset pricing model should have been lower. Could the beta have been higher? Possibly, which would have biased it upwards. What's the degree of sort of adjustment in the beta as a result of having a more complete set? We don't know. I'm willing to bet that it's not going to change that much. You know, our estimate of return on equity might be a little higher. Now, with regards to the loss estimates and that's probably what you're getting to, let me make this clear, was there overpayment in every year of premiums? The answer to that is unequivocally yes, regardless of the actual performance of the insurance companies. Now, how can I say this with certainty? Because the assumptions that were used in setting the premiums used a return in equity that too high, used a return in investment that was too low, and did not look at best practices with regards to expenses. So –

STAMP, Q.C.:

Q. So, even in the –

DR. LAZAR:

A. No, no, no, please. Please.

STAMP, Q.C.:

Q. Just go ahead.

DR. LAZAR:

A. You know, I think it's important to understand this. So, here are the premiums that were set. The premiums that were charged could have been lower for various reasons, competitive reasons or whatever. The actual performance of the insurance companies would have been—could have been different from what was anticipated and could have been different from that ten percent because the claims experience was different, their operating expenses experience were different. Okay? But here are the premiums that were set. Our argument based solely on what would have been appropriate return on equity suggests even if you use the ROI assumptions, even if you use the expense assumptions, because the ROE should have been lower, the permitted premiums would have been lower. So, you're going to get that gap year in, year out, which means you have overpayment of

premiums. Adjusting for the ROE for the return on investment and expenses expands that. Now, what happens when insurance companies lose money? It should matter to the regulator. There are assumptions made the beginning. You set the premiums. The experience is going to vary. Some years the industry will actually do better than at regulated return in equity if they got lucky. Some years they're going to do worse. They got unlucky for the industry as a whole. Within the industry in a given year, some companies do better, some do worse. So, if you're doing the analysis correctly, the actual after-the-fact return on equities from estimating the overpayments almost becomes irrelevant. What matters is what were the assumptions used in setting the premiums. What happens during the year and the final performance becomes irrelevant. So if we included a larger sample of companies, it affects the data, it would affect our estimate of the return on equity. Would it push that return on equity up to 10 percent; no way, wouldn't even come close. With regards to overpayments, even in the years when the insurance companies lost money, the answer to that is there were overpayments, period, because you used different assumptions for setting the premiums than what should have been used, plain and simple. So you can look at this data, you can say we did include these, you should have included these, what about those negative years, the reality is using logic, using common sense, using different sets of assumptions that were more appropriate, they're overpayments.

STAMP, Q.C.:
Q. We're going to come back to all that, Mr. Lazar. All of that we'll come back to, but the first piece –
DR. LAZAR:
A. Yeah, but it's –
KENNEDY, Q.C.:
Q. Is he finished? The witness has to be allowed to finish his answer.
DR. LAZAR:
A. But again we can go through these tables, you can go company to company, why didn't

you include it, we didn't have it. You have to understand what difference would this have made, and I'm saying the only place it comes in, it comes in two places; one, how does it impact the return on equity, and in my view, without looking at the companies we missed, without including them, their impacts, I'm willing to bet, would have been marginal. The worst case scenario, it would have increased what would have been appropriate after tax return on equity, 25, 50, 75 basis points. Averaged over that period, you go from 6 to maybe 6.75 percent maybe. Just as likely it could have reduced it. So that's the worst case scenario for estimating overpayments, but in terms of overpayments, premiums too high, I say unequivocally that was the case in every year regardless of what data you show me, regardless of what happens if you include those negative years. If you're going to tell me that we've got to guarantee the insurance companies generate this return on equity each and every year, then the risk is being shifted onto consumers and the return

on equity, therefore, should be equal to the risk free rate, 2.5 percent. So if you want to spend more time going through this, that's fine. I no longer see the relevance of it, but you've got the floor, you can pursue it.
STAMP, Q.C.:
Q. Sovereign Insurance is not on your list, as I see it. It wrote insurance every year just under 20 million dollars, 2.6, 3.6, 2.8, 3.2 or 3.3, 3.2, 3.9. They're not included.
DR. LAZAR:
A. Okay, but again we can go through it company by company. I'm not denying any of this.
STAMP, Q.C.:
Q. Okay.
DR. LAZAR:
A. All I'm asking is, what's the relevance of it?
STAMP, Q.C.:
Q. Right.
DR. LAZAR:
A. And I've answered what the relevance of it is.

STAMP, Q.C.:
Q. Well, you excluded Zurich, according to your note, because it didn't write –
DR. LAZAR:
A. Because we had data available on Zurich.
STAMP, Q.C.:
Q. You excluded it?
DR. LAZAR:
A. Because we had data available. These companies you're pointing out, they're not on a list, we didn't have the data available on them.
STAMP, Q.C.:
Q. The data is right here in the Superintendent's Report published every year for Newfoundland.
MR. FELTHAM:
Q. Madam Chair, this has been asked now a number of times. Mr. Lazar has given his answer. He's indicating, "I've given you my answer, it's the same answer, you can refer to each company and go through line by line, that's my answer". He shouldn't keep – it's now quarter after 12. How much time are we going to spend going over and over the same

thing.
STAMP, Q.C.:
Q. Until, I guess, I get my questions answered.
MR. FELTHAM:
Q. The problem is Mr. Stamp doesn't like the answer that he's getting.
A. But, you know –
O'FLAHERTY, Q.C.:
Q. Excuse me, Dr. Lazar, as hearing counsel, I just make the observation, Madam Chair, that Mr. Stamp is entitled to ask what dataset is relied upon in a presenter's report. Do I simply turn it back and say, you know, maybe the fastest way forward is to let Mr. Stamp ask his questions and then we can take that information which way it goes. Constantly interrupting, as I've said earlier, for the sake of good order in the transcript, it's not that helpful. So I think in the context that we're in, Mr. Stamp is simply asking about data.
DR. LAZAR:
A. If I can say something, I have no problem –
O'FLAHERTY, Q.C.:
Q. Excuse me, Dr. Lazar, just –

CHAIR:
Q. Excuse me, Mr. Lazar, you can respond to questions from the –
DR. LAZAR:
A. Okay, sorry. Thank you.
CHAIR:
Q. Mr. Stamp, I understand the tenure of your questions. Are you going to ask the same question with respect to each of the companies or is it a general –
STAMP, Q.C.:
Q. I won't do that. We'll capture this, Madam Chair, I guess, in other materials later on, but Zurich was specifically excluded we were told because they only wrote three years. Is that right, Mr. Lazar?
DR. LAZAR:
A. I can repeat this only one way. We were given a certain dataset. The companies you're pointing out were not on that dataset. With the OSFI data, I suspect all the detailed other information may or may not be available. Why MSA did not include these, go contact MSA. From our perspective, and as I said, all that

matters, if you want us to include to broaden this, great, give us the detailed information, we'll be able – we'll do it on our time, our expense, to see how it affects that measure of data, and I suspect it's going to have a trivial effect on that estimate of data, and hence on the estimate of the return on equity, okay.
STAMP, Q.C.:
Q. But, Mr. Lazar –
DR. LAZAR:
A. Now if you want us to do the complete thorough analysis, and go to the regulatory data, if you also have the ex anti-claims numbers, we can run this through. I've done some simple calculations that suggest the overpayment on the premiums probably run 8 to 10 percent per year, year in, year out, regardless of the performance, and I base this on looking at what the multiple of the claims should be based on different assumptions with regards to expense ratio, the ROE, and the return on investment. Simple calculations. I can just run through a few of these and it gives me a number of 8

to 10 percent in premium overpayments year in, year out. If you want, I'll expand the dataset, I'm going to expand the premium number and the overpayments. It's quite simple. So you want to ask me other companies that are not on the list, and why they're not in a list, the answer is the same, they weren't in the dataset that MSA sent us. Is it relevant for analysis; yes. Is it going to significant alter analysis; I'm willing to say probably not. Does it affect our conclusions with regards to overpayments on the premiums? Absolutely not.
STAMP, Q.C.:
Q. Are you done? Zurich, you report only wrote a premium or collected premium in '11, '15, and '16, and yet the Superintendent's Report shows that they were also here for '12, '13, and '14. About the same numbers through the whole piece in those years as well.
DR. LAZAR:
A. That's not what the data that we were given said.
(12:15 p.m.)

STAMP, Q.C.:
Q. Right. So what I'm back to is you had said earlier that you didn't have available the permitted premiums in Newfoundland, which are all published through this Public Utilities Board, you didn't have the data on who wrote insurance, and you just had to go to the Superintendent's information and you'd have every insurance company for every year in the period you're interested in, 2011 through 2016. Every single company is here, and you relied on 17 insurers, I guess, that you were provided with data from MSA or MSI, whatever they're called, and you excluded a bunch of those. Is that right?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. Okay, because there's, I don't know, 30 or 40 insurers here. Your report at page 12, Mr. Lazar, this is when you're speaking about the ROI, you identify the ROI produced by Oliver Wyman. That's out of their report, is it not, that table?
DR. LAZAR:

A. Yes.
STAMP, Q.C.:
Q. At Table 6?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And at Table 7, you produce a table that some of it is GISA data, and some of your own calculations, I believe. Is that correct?
DR. LAZAR:
A. These should all be derived from the GISA data, yes. Some of these ratios.
STAMP, Q.C.:
Q. Well, let me just make sure I'm clear, first of all, just a couple of point. If you can pop ahead to page 14, and Item 4. I want to make sure we speak the same language. You say in Item 4, "The returns on equity, or ROI, keeping in mind the preceding observations, were in excess of 10 percent". Are you saying both, or is ROE and ROI the same thing?
DR. LAZAR:
A. No, they're different.

STAMP, Q.C.:
Q. Are you referring to both here or just one?
DR. LAZAR:
A. I'm just referring to one.
STAMP, Q.C.:
Q. Which one are you referring to?
DR. LAZAR:
A. The return on their investment portfolio.
STAMP, Q.C.:
Q. So you're not referring to equity here?
DR. LAZAR:
A. No.
STAMP, Q.C.:
Q. Returns on equity is not being referred to?
DR. LAZAR:
A. No.
STAMP, Q.C.:
Q. You say that it is, but it's not, I take it?
DR. LAZAR:
A. Not in that point.
STAMP, Q.C.:
Q. Okay, and at page 30, if you can just turn to that page, there's a series of bullets there, and again I'm trying to understand what terminology you use, or what you

understand to be the discussion, in the fifth bullet it says, "Expected investment income return on equity". Is that the same thing?
DR. LAZAR:
A. No, it's the investment, return investment, the denominator we equated with equity, and again if you go to the preceding table, that's how the numbers are calculated, and here investment return on equity, it's not the return on equity, the net profit of the company divided by their equity, but rather their net investment income divided by their investment portfolio, which we equated with equity. This is not the return on equity, it's the return on their investment.
STAMP, Q.C.:
Q. So, is bullet 15 (sic) properly explained or properly described?
DR. LAZAR:
A. Bullet? Well, we thought it was properly described, but obviously it was misinterpreted. We said, "Return on equity". We just stated explicitly the "return on equity".

STAMP, Q.C.:
Q. Okay, all right, just come back to Table 7 at page 13, please.
DR. LAZAR:
A. Which table?
STAMP, Q.C.:
Q. Seven.
DR. LAZAR:
A. Seven.
STAMP, Q.C.:
Q. And three parts of the way down that table, there's a net investment income?
DR. LAZAR:
A. Yeah.
STAMP, Q.C.:
Q. And below that an allocated equity, and then you divide the two?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And that gives you 15.08 in '12, 10.9 in '13, and so on, up to 6.4 in '16. Is that right?
DR. LAZAR:
A. Yes.

STAMP, Q.C.:
Q. And you identify that as return on equity, do you not?
DR. LAZAR:
A. No, that's return on investment.
STAMP, Q.C.:
Q. It's return on investment?
DR. LAZAR:
A. Okay, there are two parts here, and they both involve equity, so assuming the equity that companies commit a certain amount of cash, that's equivalent to the reserves that are available to invest. So we assume that the two are the same. So that pool is available and invested in a group of financial assets. What we're measuring here is what's the return on that investment pool, and that will then filter into determining the overall profitability of the companies. Then you look at – the last line there, and the insurance companies, they make underwriting profits or losses, they make money on all their investments. Add the two together, that gives you your overall profitability. Profit or loss, you

divide that by the equity. That's the return on equity. So the return, what we call return on investment – a line that comes farther up in that table, that's just one component of their overall profitability.
STAMP, Q.C.:
Q. But I'm looking at this line, investment income over equity. Now, am I looking at a return on investment?
DR. LAZAR:
A. Return on investment.
STAMP, Q.C.:
Q. I take it -- and this pops up at your Table 9 as well -- the same numbers show up in Table 9?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. So, if I take $1,000 and invest it and earn $100, I do a calculation that says what my return on my investment was.
DR. LAZAR:
A. Ten percent.
STAMP, Q.C.:

Q. If I happen to own a house, I don't throw that into the discussion to see what my return on my investment was. I just take the $1,000 I invested and the income I made on that $1,000, don't I?
DR. LAZAR:
A. See that's – if you do that, that's because you didn't take a finance course. Because finance makes it quite clear, you have to look at all your assets, not just pure financial assets.
STAMP, Q.C.:
Q. Um-hm.
DR. LAZAR:
A. For most people, the house is the biggest asset.
STAMP, Q.C.:
Q. Right.
DR. LAZAR:
A. So you throw that into the base and you look at what is – so, your capital appreciation. I mean there's capital losses on that less whatever sort of maintenance expenditures you incur.
STAMP, Q.C.:

Q. But I understood you to say that the return on equity, ten percent which is the benchmark, is too high and one of the reasons it's too high you said, I thought, was that rates of return on investments, ROI, was given at a certain amount but it was actually, in your view, higher than the insurers said it was. And therefore -
DR. LAZAR:
A. No. Those two are unrelated. The return on equity that we estimated that would be appropriate was derived from – okay, what's the risk profile of this industry? So, you look at any type of asset class, any type of company, and you've got here's the risk-free return. How much more should that asset generate on average? How much more should that company earn on average on its equity investment in that company? And that depends on the risk profile. The risk profile is derived from applying the capital asset pricing model. So, that's what we did and that generated a return on equity.
Now, we then looked at the actual

returns on equity and they're going to be influenced in part by the returns the companies generate on their investments in their investment portfolio. And again, if you look at the GISA data and the returns on investment, at those levels that just reinforced the point I made earlier that there's no way you can generate those returns by investing two-thirds of your portfolio in bonds during that period of time.
STAMP, Q.C.:
Q. Well, that's a very long answer.
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. But it did say somewhere in that answer that return on equity was in part derived out of ROI.
DR. LAZAR:
A. I didn't say that.
STAMP, Q.C.:
Q. I thought you did.
DR. LAZAR:
A. Well, no, I didn't.

STAMP, Q.C.:
Q. Okay. In any event, you're saying – what you're saying – let me just make sure we have this clear, is that return on investment, you don't take the amount you've earned on the investment and divide it by the amount of the investment to get the return on the investment, to get the rate of return? That's not how you do it? Is that right?
DR. LAZAR:
A. No, that's exactly how we did it.
STAMP, Q.C.:
Q. Oh, okay. Oh, that's how you did it?
DR. LAZAR:
A. Um-hm.
STAMP, Q.C.:
Q. That's how you did it?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. Well, I had just said a few minutes ago I invest $1,000, earn $100 on it -
DR. LAZAR:
A. Right.

STAMP, Q.C.:
Q. - and that tells me what my rate of return was.
DR. LAZAR:
A. But you then said you had a home and you didn't include that.
STAMP, Q.C.:
Q. Didn't include that in calculating that investment.
DR. LAZAR:
A. Right. And that's what I said you're wrong.
STAMP, Q.C.:
Q. So, to have my return on my $1,000 investment calculated properly, I got to include the value of my home?
DR. LAZAR:
A. No. If you're looking at what's the return you've made on your -
STAMP, Q.C.:
Q. On what?
DR. LAZAR:
A. On your assets.
STAMP, Q.C.:
Q. Different thing though.
DR. LAZAR:

A. Your assets will consist of financial assets plus real estate. It could also consist of other assets, furniture, jewelry, whatever. So, when you look at what's the net wealth position of an individual, it takes into account all these holdings. That becomes the denominator and then the numerator becomes what are your capital gains, what are you dividends, interest payments you receive during that period of time.

STAMP, Q.C.:

Q. Well, Mr. Lazar, I'm still troubled by the confusion because at the bottom of page 15 you talk about the implication of a higher ROI, which means you have to study – you have to examine the ROI in order to make certain conclusions that you have made and the ROI is different from the ROE, is it not?

DR. LAZAR:

A. Yes.

STAMP, Q.C.:

Q. So, you have to get the ROI as well. It's a component you got to get?

DR. LAZAR:

A. It's a component in the rate setting process.

STAMP, Q.C.:

Q. Right. And so, you pulled a rate of return by dividing investment income not by the amount of the investment but by the amount of equity.

DR. LAZAR:

A. Because we assumed that the two were equivalent.

STAMP, Q.C.:

Q. Okay. So, you assumed that every company's investment happens to coincide perfectly with every company's equity?

DR. LAZAR:

A. Only in this particular case, automobile insurance. With other companies – let me think – their investments – okay, so look at the case of the banks. Well, financial institutions, if you look at banks, their investment pool most likely exceeds the equity invested in the company. Most other companies, manufacturing companies, they're going to be sort of comparable. I'm trying to think of some of the technology

companies, their investment pools likely are less than the total equity.

STAMP, Q.C.:

Q. Short answer for what you've told me, I think, is that you treat investment and therefore how to calculate the rate on that investment, the rate of return on it, you treat investment as equal to the company's equity?

DR. LAZAR:

A. Yes.

STAMP, Q.C.:

Q. Thank you.

DR. LAZAR:

A. For automobile insurance companies; and the sole reason we did that, that was the assumption used by FSCO in the rate setting process.

STAMP, Q.C.:

Q. I'm going to refer you, Mr. Lazar, to Ms. Elliott's evidence.

DR. LAZAR:

A. Sorry, to what?

STAMP, Q.C.:

Q. Ms. Elliott's evidence, Paula Elliott.

DR. LAZAR:

A. Okay.

STAMP, Q.C.:

Q. She was here with Oliver Wyman testifying.

DR. LAZAR:

A. Yeah.

STAMP, Q.C.:

Q. They're the Board's actuarial consultants.

DR. LAZAR:

A. Yes.

STAMP, Q.C.:

Q. And at page 85, 86, 87, 88, I guess that all shows up on one page for our technical assistant.

CHAIR:

Q. What date?

MR. FELTHAM:

Q. Madam Chair, I guess if we could -

CHAIR:

Q. Are you referring to the transcript?

STAMP, Q.C.:

Q. September the 6th, yes.

DR. LAZAR:

A. So, you're not referring to a report?

(12:30 p.m.)

CHAIR:
Q. It'll be a transcript reference, Mr. Lazar.
DR. LAZAR:
A. Oh, okay.
CHAIR:
Q. It should show up there, yeah.
STAMP, Q.C.:
Q. We're discussing with Ms. Elliott this concept of ROI and at the very top of page 86, my question is "and so, it's a division of course to get that number parity, but from 2012-2016, the authors of this report come up with investment income to equity. Is that ROI? Is that what they're thinking about?"
Ms. Elliott's response is "No, this is not. ROI is return on your investments which is a ratio of your investment income divided by your invested assets. What's presented here in this row is the investment income divided by the equity and the equity does not equal the invested assets."
So, you have it as a proxy. Ms. Elliott says it is not a proxy.
DR. LAZAR:

A. Okay. And did she provide any estimate or number of the invested assets?
STAMP, Q.C.:
Q. If we just turn to page 90, and at page 90, Ms. Elliott is speaking about this topic again, because I explained how your numbers were fundamentally different from hers and she said "Right. No, because a return on investment rate are your investment income including the realized capital gains and losses. That's included in the number that we present and it's taken as a ratio of the average at the beginning of the year and the end of the year of your investment assets that you have. So, all your investments, your bonds and your stocks and everything else, these are the actual return on investment rates that are reported in what's referred to as a P&C-1, a financial statement that is audited, and each company is required to file this annually with the regulatory OSFI. So, our numbers are different. What Lazar has presented is a ratio of the investment income as he has extracted it from GISA exhibit divided by

equity and equity in invested assets are not the same." Investment assets are not the same thing I think she's saying.
So, I asked does it make any sense the way you did it, and at the top of page 91, she says "no, because it's not an ROI". And of course, down at the bottom of page 91, she says and it would have been a flag. You see at the bottom, she says "and so, if you see this measurement as presented by Lazar, you know, double digit 15 percent, we know that would be a red flag because we know that government bonds that companies invest in are not 15 percent. So, it's different. Something else, it's not ROI."
Now, Mr. Lazar, you were asked questions by the Public Utilities Board and we've gone through some of them and I think we'll have a look at -
KENNEDY, Q.C.:
Q. Excuse me, Madam Chair. Is there a question there? He just read from a transcript and said Ms. Elliott said this and now he's moving to another area. I mean, if you're going to do that, there has to be a

question.
STAMP, Q.C.:
Q. I pointed out to Mr. Lazar that Ms. Elliott has taken a fundamentally different position; that she does not agree that investment and equity are the same thing. Mr. Lazar has said one is a proxy for the other and she disagrees. That's my point again.
CHAIR:
Q. To be fair, Mr. Lazar should be able to respond to it.
STAMP, Q.C.:
Q. Sure. He can respond to that if he wishes.
DR. LAZAR:
A. I'll only have two comments. If I'm not mistaken, in her work the only return on investment she included were dividends and interest payments. She didn't include any capital gains on any of the financial assets. And second, I don't recall in her report any data on what the magnitude were of these assets, and what's in the response what the magnitude of these assets. So, if she says they're in the OSFI filings,

wonderful. What's the number and how does it differ from the equity number that we're approximating?

I mean, even if you double the denominator saying invested assets are twice the equity, which I seriously doubt is the case, that still reduces returns to numbers well above hers.

STAMP, Q.C.:
Q. Mr. Lazar, you were asked by the Public Utilities Board in questions that they put to you.
DR. LAZAR:
A. Yeah.
STAMP, Q.C.:
Q. This is Question 2B, and the question is: "Do Dr. Lazar and Dr. Prisman find invested assets to be the same as equity?"
DR. LAZAR:
A. Yeah.
STAMP, Q.C.:
Q. So explain why in the audited financial statements the invested assets, P&C1, page 20.10, are a different value than the equity, P&C1, page 20.20, for each insurer?

And then your response, I take it it's your response, is as follows, "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." So now you're telling us here not only that it's because FSCO does something, you also tell us you don't have any data for reserves?
DR. LAZAR:
A. Not in the database that we had.
STAMP, Q.C.:
Q. No, okay.
DR. LAZAR:
A. Is there any documentation from OSFI what the assets were and compared to the equity assumptions we made? I'd be curious to see them.
STAMP, Q.C.:
Q. Mr. Lazar, in your report at page 30, you have a discussion on operating expense ratios?

DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And then that discussion is taken out more fully I think in page 16 of your report?
DR. LAZAR:
A. Page 16?
STAMP, Q.C.:
Q. I believe. So you will see at Table 10 a comparison of general expense ratios, GISA and Oliver Wyman, and of course, the purpose of you including this, is it not, to show that the Oliver Wyman expense ratios are higher than GISA, was that the purpose of it?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And the Oliver Wyman column comes right out of the Oliver Wyman report and I just might mention for the record it's at page 21, Table 12 of the Oliver Wyman report, but your numbers, you say, are, you say they're GISA numbers?
DR. LAZAR:

A. I think if you go back to Table 7 that's where they are.
STAMP, Q.C.:
Q. Yes. You're referring to the general expense ratio?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. Right. Now, Oliver Wyman's information, we're told by Ms. Elliott here in her presentation, came out of the GISA Industry Expense Report. The industry expense report, she said, provided the information for expense ratios for each of the years, actually only provided for '13, '14, '15 and '16, I think she had to do a calculation for '12, but certainly the industry expense report at Page 20, this is the GISA Industry Expense Report, has those rates, simply add the two expense rates to get the 8.2, 7.2, 8.5—not 8.2, sorry, 7.2, 8.5, 7.7 and 9.1.
KENNEDY, Q.C.:
Q. Is this a document we have?
CHAIR:
Q. It's Oliver Wyman's report.

STAMP, Q.C.:
Q. This is the one I referred to with Ms. Elliott when she was giving her evidence. We spoke about it then, she spoke about it herself in her evidence or in her presentation and explained where she got her data. So, my –
KENNEDY, Q.C.:
Q. The witness has got to be shown the document, either put it on the screen or show it to the witness. You just can't simply, Madam Chair, question a witness on a document that you're interpreting the evidence of what someone else said without showing the witness the document.
O'FLAHERTY, Q.C.:
Q. Madam Chair, it's Table 12 of Ms. Elliott's report.
KENNEDY, Q.C.:
Q. I don't think so, Mr. O'Flaherty.
STAMP, Q.C.:
Q. That's where the numbers come, that's where the numbers are. She explained, Mr. Lazar –
KENNEDY, Q.C.:
Q. That's not the document he's referring to.

STAMP, Q.C.:
Q. She explained where she got those numbers, Mr. Lazar.
CHAIR:
Q. Was that in the transcript, Mr. –
STAMP, Q.C.:
Q. Oh yes, it's in the transcript. Where she spoke about this you mean, Madam Chair?
CHAIR:
Q. Yes.
O'FLAHERTY, Q.C.:
Q. Profit rate adequacy. Just one second, Mr. Stamp, we'll just bring it up for you.
FRAIZE, Q.C.:
Q. For clarity, what table are we looking at?
O'FLAHERTY, Q.C.:
Q. 21, page 21, just one second, Mr. Fraize and we will bring it up there for you. I believe this is what we are referring to.
STAMP, Q.C.:
Q. So I'll take you to this in just a moment, Mr. Lazar, but I just want to make sure your expense ratios, the GISA, 5.7, 4.8, 5.8. 5.6 and 6.0, where did you get those?
DR. LAZAR:

A. From the GISA document.
STAMP, Q.C.:
Q. Which document please?
DR. LAZAR:
A. If I can find it here, make sure I open up the right file. So I'm having difficulty figuring out where it is here on my list, but it was a GISA document. Maybe I shifted it over here. Again, my apologies, I haven't got this organized the best way. So I can't find the exact document here, but it's a GISA document from which my Table 7 was extracted.
STAMP, Q.C.:
Q. Ms. Elliott said it was the Industry Profit and Loss Report that GISA publishes.
(12:45 p.m.)
DR. LAZAR:
A. Most likely that is the case. Here it is, GISA report, automobile insurance financial information, Industry Profit and Loss, that's the report. And footnote give gives the reference.
STAMP, Q.C.:
Q. I'm sorry, on footnote 5 in your –

DR. LAZAR:
A. In my report.
STAMP, Q.C.:
Q. It's page 25 of the GISA –
DR. LAZAR:
A. No, page 13.
STAMP, Q.C.:
Q. No, no, but you're referring in your footnote to page 25 of the GISA report.
DR. LAZAR:
A. Table on page 25 in the GISA report, yes.
STAMP, Q.C.:
Q. Right, and Ms. Elliott referred to that same page. When you used the numbers that you used, of course, we know that the total expense ratio that Oliver Wyman produced are set out in Table 12 of the Oliver Wyman reform, of profit review document, right, do you know that?
DR. LAZAR:
A. I'm sorry, I didn't hear that.
STAMP, Q.C.:
Q. We have to bring up page 21 of the Oliver Wyman profitability review.
CHAIR:

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Q. Is that the one that's up, Mr. Stamp?
STAMP, Q.C.:
Q. Oh yes, sorry, it is up there, sorry. So, Mr. Lazar, the total expense ratio for those years is made up of three components?
DR. LAZAR:
A. Uh-hm.
STAMP, Q.C.:
Q. Commissions, premium taxes, general expenses and total expenses, which Oliver Wyman puts at 28, 23, and so on. You have a different total expense ratio because you have a different general expense ratio, is that correct?
DR. LAZAR:
A. Correct.
STAMP, Q.C.:
Q. Simple as that.
DR. LAZAR:
A. Apparently.
STAMP, Q.C.:
Q. How did you determine that the number they had put in for commissions was correct? Did you check that?
DR. LAZAR:

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A. No, it wasn't broken down, so I took her numbers.
STAMP, Q.C.:
Q. It wasn't broken down?
DR. LAZAR:
A. Not, no, looked at the general numbers, so it was included in acquisition expense ratio.
STAMP, Q.C.:
Q. So are you aware of whether or not GISA data specifically identifies the commission percentage in the reports it produces?
DR. LAZAR:
A. I'd have to go look, back and look at the data to answer that question.
STAMP, Q.C.:
Q. And how did you satisfy yourself that the premium taxes that Oliver Wyman listed in Table 12 were acceptable?
DR. LAZAR:
A. I had no reason to question that.
STAMP, Q.C.:
Q. Okay, so the only question that you had was with the general expense piece, is that right?

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DR. LAZAR:
A. Was the general expense ratio, yes. Now, can I just make a comment?
STAMP, Q.C.:
Q. I'm just going to ask you questions, please, if I can, Mr. Lazar.
MR. LAZAR:
A. Okay, I'll be patient.
STAMP, Q.C.:
Q. One of the things that I can point you to on this discussion is again at Ms. Elliott's evidence, because I asked her about where you got your expense rates that you have in your table, the one we just looked at a moment ago, your expense ratios at your Table 10. I asked her about that and if you can go –
CHAIR:
Q. Page 97 of that transcript.
STAMP, Q.C.:
Q. Yes, thank you, Madam Chair.
KENNEDY, Q.C.:
Q. Sorry, what date is that?
STAMP, Q.C.:
Q. September 6th. So I asked her about this and

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I said, "They suggest that the column that they used, GISA numbers, they pulled that out of, I guess, the same report maybe?" Ms. Elliott says, "No, they pulled that out of 9501. What they're presenting is a subset of the general expenses, so they're both from GISA, but one is a subset of the general expenses, the column labelled "OW" which is GISA 9502, is all general expenses." And I said, "Right, and is that the report you're referring to called the Industry Profit and Loss Report?" And she says, "Under the column, GISA, yes." And I say, "Right, okay, and so they've essentially jumped from one GISA report with the expenses that they show attributed to Oliver Wyman, they actually, they're actually GISA, jumped to a different report?" Ms. Elliott says, "Right, they have used a profit and expense report which presents a subset of the general expenses and didn't use the total general expenses which is available in the report that we used that is specific to private passenger expenses only." I asked then, "So can you offer any explanation why the authors would have left the expense report, the industry expense report that has the data right in it, and gone to a different report to take a different set of expense percentages?" Ms. Elliott says, "I have no idea why, I don't know." I asked, "Does it make any sense?" She says, "No, I don't agree with their number, they are missing a component of the general expenses." And I say, "You're not comparing apples and apples?" And she says, "Right." So her point is, and you can answer this, Mr. Lazar, you've missed expenses when you used the percentages that you used which she says comes from the Industry Profit and Loss Report and don't come from the Industry Expense Report.

DR. LAZAR:

A. Okay, I'll answer this as quickly as I can. I'm sure Ms. Elliott is a great actuary, I'm not going to question her, I'm sure she's extremely good. She's not an economist and she misses the point entirely. So let's take her expense numbers, use those, and I believe it's one to put in context, what's

the relevance of all of this if we use a higher number? There is no relevance for the question of did consumers of auto insurance in this province pay too much? It's not relevant and here's the reason why. If you accept her expense numbers, let's take them, so they're going to enter into the rate setting process. What are the two key variables that we still disagree upon? The return on equity and the return on investment. The return on equity, Ms. Elliott, that was not her area of expertise, that's not what she was asked to do. So all I'm saying is even if we take her expense numbers for the time being, plug them in and let's go through the exercise, let's determine what the maximum premiums would have been allowed with a 10 percent return in equity, whatever number you want for the return on investment, here the premiums would have been allowed, redo that with a lower return on equity number, use her return investment if you want, use her expense numbers, that maximum allowable premium is going to be lower, which means

consumers have overpaid. I don't care how—what numbers you use, how you try to cast this. Now, even if you use her numbers and again, she's not an economist, so I can't blame her for this, you've got to take into account what are best practice, what are expense ratios that should be the target for the Board.

STAMP, Q.C.:

Q. Madam Chair, if I can just interrupt here. It's not focussing on the question that I asked, it's focussing on –

DR. LAZAR:

A. Yes, but there's got to be context.

STAMP, Q.C.:

Q. It's giving us a seminar that he gave earlier in his direct evidence or his direct presentation.

DR. LAZAR:

A. But again, it's the context, you're asking me these questions, what the difference is, so the question is what difference does it make for the fundamental question, and my answer is it doesn't, there are overpayments, regardless of what numbers you

throw in because of the differences in return on equity that were used and that should have been used, that's the bottom line. Then, is her number the right one to have been used in the exercise, that's another question. And my answer to that is, no, it's not, regardless of general expense number it's the wrong number to use because, again, not being an economist, you don't realize that part of the regulatory process is to incentivize the companies that are being regulated to achieve the best practices.

STAMP, Q.C.:

Q. Madam Chair, you know, we're getting a seminar here. I'm getting a lecture.

CHAIR:

Q. Did you get an answer to your question, Mr. Stamp?

STAMP, Q.C.:

Q. Well my point was, simply this –

CHAIR:

Q. Did you ask a question first of all?

STAMP, Q.C.:

Q. I asked a question, but first of all I'm going to go back because Mr. Lazar keeps going around and around in these long-winded answers. The fact is he has said the expense ratio doesn't matter. Now he's explained it's one of the three, I think, critical points to why he says the premium is overpaid.

CHAIR:
Q. I think we're going around in circles here. I just wanted to know if you got an answer to the question that I thought you asked.

STAMP, Q.C.:
Q. I'll ask it again, Madam Chair.

CHAIR:
Q. Okay, that's fair enough.

STAMP, Q.C.:
Q. Why would you exclude pertinent expenses from the expense ratio?

DR. LAZAR:
A. Because the dataset I had and we used didn't distinguish them.

STAMP, Q.C.:
Q. Okay, so you didn't look at all of the charts that were available, you looked at one chart and picked it, is that correct?

DR. LAZAR:
A. That seemed to be the relevant chart because it's dealing with the profits of the industry.

STAMP, Q.C.:
Q. Well Ms. Elliott, who is an actuary and studies this all the time, says you looked at the wrong chart.

DR. LAZAR:
A. But the issue is what does that have to do with estimating overpayments?

STAMP, Q.C.:
Q. Well it has this to do, does it not, Mr. Lazar, doesn't it suggest that the overpayment that you are contemplating or advancing has occurred, you're wrong on the expense ratio, that's one of the critical points that you've made.

DR. LAZAR:
A. No, my answer is our analysis, whether you accept it or not, is if you were to have done the right analysis, to do it thoroughly you conclude unequivocally and I'll repeat it again and I hate to repeat things, but 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. And then the other question becomes, even if you take her number –

STAMP, Q.C.:
Q. So, go ahead, go ahead.

DR. LAZAR:
A. Okay, she used it to try and estimate premium over underpayment for 2017, but she never asked the question what are the best practices, so our criticism of her work was when she tried to take what she had done and then try to extend it to deal with what should be the fundamental question here, were premiums too high or too low? That's where our criticism came in and that's my criticism of her work, period.

O'FLAHERTY, Q.C.:
Q. Madam Chair, earlier this morning we had discussed perhaps we would check at around 12:45 and I see we are past that, to see how we were progressing with the examination and I have spoken with my learned friend, Mr. Browne, and he indicated that he had a time

estimate he could share with us once we find out from Mr. Stamp as to how he's progressing with his questioning to determine how we move forward.

CHAIR:
Q. Mr. Stamp, I don't want to put you in a position of having to tell us how long you are going to be, but –

STAMP, Q.C.:
Q. Madam Chair, we would typically stop at 1:30, but if we kept going, we won't stop at 1:30, so if you wish to take a break, that's, you know, probably the best thing to do if you feel that that is –

CHAIR:
Q. Well, yes, let's take a fifteen-minute break, let everybody get prepared for another, what appears to be at least an hour or so, at least.

KENNEDY, Q.C.:
Q. Madam Chair, if we're going to do that, I'd suggest we take a lunch break. I mean, we sat here yesterday until 2:30, you know, this is just—we are sitting from 9:00 in the morning to 2:30 in the afternoon. It's a

very long time to be sitting here like this. I mean, we've got the witness, we've got staff members, we've got all of us. If we're not going to finish, I'd just as soon take the lunch break, come back and just keep going, like we would do as if we were in a courtroom.
O'FLAHERTY, Q.C.:
Q. I don't think everybody has the availability. I'm seeing heads being shaken behind Mr. Kennedy, so I think, I don't think that's going to be workable, Madam Chair.
CHAIR:
Q. We're just going to push through to finish Mr. Lazar and whatever break is going to be needed here, we'll take, so –
STAMP, Q.C.:
Q. Did you want to take a break now, Madam Chair?
CHAIR:
Q. We'll take a fifteen-minute break and we'll come back, is that okay for you, Mr. Browne?
BROWNE, Q.C.:
Q. Yes, that's fine, Chair. We can't go over

the 2:00 mark, there's commitments and I'll only be 10 minutes at most. My questions will be quite specific.
CHAIR:
Q. I understood yesterday, I think what we had agreed to is that we would stay until we finished Dr. Lazar, so that's what we'll try to do. Is your flight out today, sir?
DR. LAZAR:
A. 5:30.
CHAIR:
Q. 5:30, okay. Thank you, see you in about fifteen minutes.
(RECESS – 1:00 p.m.)
(RESUME – 1:15 p.m.)
STAMP, Q.C.:
Q. Batteries recharged, Mr. Lazar?
DR. LAZAR:
A. I think so.
STAMP, Q.C.:
Q. Good. Mr. Lazar, look, on this point generally that we've been talking about, what you say is it doesn't matter about the expenses if they're what Ms. Elliott says, it doesn't matter if the ROI is what she

says, it all comes down to they've got to find best practices, is that where you are?
DR. LAZAR:
A. That's one of the issues.
STAMP, Q.C.:
Q. And because, as we have already talked about, she has said to this panel in her evidence, in her presentation, that you have approached the ROI incorrectly. She also said you've miscalculated the expense ratios because you left out expenses, and these are the things that she says lead you where you have gone, to wrong conclusions. But you say it doesn't matter because, I think you're saying best practices have to come into play?
DR. LAZAR:
A. Okay, well I took advantage at the break to do some sort of rough calculations, to get an estimate of what the overpayments were, and –
STAMP, Q.C.:
Q. No, I don't want to go back to that overpayment, I want to come back to the expense ratios.

DR. LAZAR:
A. No, no, but it's –
STAMP, Q.C.:
Q. I want to stay focused on the questions.
DR. LAZAR:
A. Okay, but your question is saying, gee, if we accepted everything Ms. Elliott said, then our estimates of the overpayments would disappear, her numbers that suggest there's actually been underpayments would be valid.
STAMP, Q.C.:
Q. But you still say to that it's still not good enough because you've got to find a better way to do business?
DR. LAZAR:
A. I'm saying that's one variable. I mean, I was going to say I did some calculations and –
CHAIR:
Q. Just a second now, did you get an answer to your –
STAMP, Q.C.:
Q. No, I'm trying to be clear, I don't want to go back over everything we've done, Mr. Lazar.

MR. LAZAR:
A. No, no, I'm not going to go over it, I'm just wanting to give you some indication of what the differences are.
STAMP, Q.C.:
Q. Well we have Oliver Wyman's calculations –
CHAIR:
Q. But Mr. Stamp hasn't asked for that question.
STAMP, Q.C.:
Q. We have Oliver Wyman's calculations as to the answers that she has provided, what I want to make clear is this, you're saying that if her expense calculations, her expense ratio which she says I took all the expenses and she says you didn't take all the expenses. To that, you say, I took what I had and I didn't know about some other chart and it doesn't matter, you said anyway, I think, did you?
DR. LAZAR:
A. It doesn't matter in –
STAMP, Q.C.:
Q. The expenses of what she says or what you say, it doesn't matter, did you say

DR. LAZAR:
A. In terms of determining the overpayments, yes.
STAMP, Q.C.:
Q. Right, so how can it be that an important element like expense ratios doesn't make any difference? Why have you spent so much time talking about it if it makes no difference?
DR. LAZAR:
A. Essentially to sort of cast some doubt on her methodology for trying to determine are the premiums too high or too low for 2017. As I said in my presentation, if she had stopped before that, whatever numbers she has, those are her numbers, you presented the facts as you know them, that's wonderful. But it doesn't address the question that Eli and I were asked to address, have the premiums been too high or too low, that was our question. And until she moved in that direction, we would have had very few comments to make.
STAMP, Q.C.:
Q. So essentially, then, everything up to her conclusions as to 17, you would not disagree

with?
DR. LAZAR:
A. I would have no reason to sort of challenge them, I might disagree with the numbers, but I'm saying these are the numbers she presented and they're of little relevance for the questions that Eli and I were asked to address.
STAMP, Q.C.:
Q. Okay, but one of those questions that she has spoken about, or one of the issues she spoke about is ROI, and she says you and she are on a different page when you discuss ROI. She says you're not talking about ROI like she's talking about it, you're talking about something else. That's a difference she has that gives her a different ROI than you give.
DR. LAZAR:
A. Except the question I have in my response earlier was she only included dividend and interest payments in terms of the return on the investment and in terms of her denominator, I have no idea what numbers she used. We didn't see any number, all we saw

was the ROI percentage. I know I went into the numerator, I don't know what was the denominator and how that differed from what we used. So that was a question that we posed.
STAMP, Q.C.:
Q. I'm pretty certain she spoke about including capital gains. You turned to page 90 –
DR. LAZAR:
A. No, no, no, go to her report, forget about what she did in the testimony. We went by her report. I don't know what she testified here, but in her report there are only dividends in interest payments.
STAMP, Q.C.:
Q. Where are you referring to?
DR. LAZAR:
A. Sorry?
STAMP, Q.C.:
Q. Where in her report are you referring to?
DR. LAZAR:
A. When she defines the returns there. I don't think she mentioned at all capital gains.
STAMP, Q.C.:
Q. Take us to where you are on that point, Mr.

Lazar, please.
DR. LAZAR:
A. I'm going to have to, so I believe through her whole report here, claim methodology, expenses, investment income, okay, so we used, the rate that was calculated there was investment income, I guess on her page 8 she doesn't really explain this.
STAMP, Q.C.:
Q. Are you saying she didn't include it?
DR. LAZAR:
A. The numbers she had there did not, I'm sure –
STAMP, Q.C.:
Q. Where are you, Mr. Lazar, I'm sorry, can you tell us where you are?
DR. LAZAR:
A. I'm looking at page 8 of her report.
STAMP, Q.C.:
Q. Of the March 29, Oliver Wyman report?
DR. LAZAR:
A. Table 6, okay, that's where she has the investment rates and she does not discuss what goes into the numerator, what are the returns.

STAMP, Q.C.:
Q. So how did you conclude from that that she didn't take that into account?
DR. LAZAR:
A. I just looked at the low returns, I did a comparison to, I think, what company do I have here? Intact, where Intact reported their investment returns and their investment returns were clearly only dividends and interest payments.
STAMP, Q.C.:
Q. I don't know about Intact, but I know that Ms. Elliott testified here, page 90, that she took into account, I think it was here that she said –
DR. LAZAR:
A. She didn't state that at all in her report and given the values here, the low values, that could only suggest that what was included were dividend and interest payments.
STAMP, Q.C.:
Q. Mr. Lazar, you talk about, let me just make sure I've got the right report here in front of me now, at page 11 of your report, it's

above Table 5, you see that Oliver Wyman did disaggregate the operating expenses in the three categories.
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. I asked Ms. Elliott about all that and you'll find that discussion, or we can find that discussion at page, I think it starts at 104, but primarily at 105, I point out at the top of page 105, this is all the September 6th hearing date again that we're referring to, and I'm referring to a table. I say, "The authors say"—this is at line 4, 5, "The authors say that Oliver Wyman did disaggregate the operating expenses into three categories and describes those categories and the breakdown is presented in Table 5." And I'll skip down, she says, "That's correct." I say, "So it wasn't the case that Oliver Wyman broke the numbers down as we have in this table, the GISA numbers are broken down that way?" She says, "That's correct, yes." And a little further down on the page 106 at line 8, she

says, "It's all clearly that I'm just taking the numbers from the chart and putting them in the table for our report." "So it wasn't Oliver Wyman that disaggregated, it was GISA had done this?" "Uh-hm, yeah." So the point that she's making is she's taken the expenses and the point that she's making, of course for your purpose, is that she took it all from the Industry Expense Report and she says I don't know why Mr. Lazar went to the Industry Profit Report to take a subset of those expenses. So I'm going to leave this topic, but if you have anything to say on that point before I go, by all means, this is the time to say it.
DR. LAZAR:
A. I'm trying to remember in her report she referred to GISA's—okay, what was it? Yeah, Financial Information Industry Profit and Loss Report for Private Passenger Automobiles, she referred to that and she made some comparisons.
STAMP, Q.C.:
Q. She used two reports.
DR. LAZAR:

A. Well, that's what's referred to here on her page 11, and that the report we went to and used and took those numbers. Up to that point, again her original report, that had nothing to do with Oliver Wynman. We used the MSA data. We only went to the GISA data after we got the Oliver Wynman Report and her reference here is strictly to this report, Financial Information Industry Profit and Loss Report for Private Passenger Automobiles. That's the report we used. Now it seems that she claiming she used a different report. If so, I don't see any reference to it. Perhaps I missed it, but I don't see that Eli and would both have missed that.
STAMP, Q.C.:
Q. That's fine.
DR. LAZAR:
A. Okay.
STAMP, Q.C.:
Q. Her presentation is here on that point, so we have all that already.
DR. LAZAR:
A. Okay.

STAMP, Q.C.:
Q. I'm going to turn, Mr. Lazar, to the claims ratio, and this—again, you picked this up at, in your report, at—again, picked up or mentioned again in that group of bullets at page 30.
DR. LAZAR:
A. Yeah.
STAMP, Q.C.:
Q. You'll see in the second bullet 79 percent, approximately halfway between the GISA for 2016 and Oliver Wynman's assumption for '17. So, what, you just did an average? Is that right, or an approximate average?
DR. LAZAR:
A. Yeah, just an average, a simple average.
STAMP, Q.C.:
Q. Sure. Okay. And you point out in your report, I think it's table 12 that you got your claims ratios from a GISA FII PNL Report or ratios from that report?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. Is that right?

DR. LAZAR:
A. That's going back to table 7 in our report.
STAMP, Q.C.:
Q. Right, and I'm going to suggest to you that's right out of that same GISA Industry Profit and Loss Report?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. But Oliver Wynman of course as you know, has generated and they've calculated the loss ratios based on accident year?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And there's a focus on that issue in her presentation that you don't—you say over time it'll all be a wash, I think you said maybe?
DR. LAZAR:
A. Yeah, it should average out.
STAMP, Q.C.:
Q. Yes.
DR. LAZAR:
A. Whether it's three years, five years, eight

years, I don't know the exact timeframe, but it should wash out.
STAMP, Q.C.:
Q. Yes, yes. So, if you wait long enough, it'll all sort itself out, but she uses the accident years for a particular reason she explains. Did you know what she had said about that?
DR. LAZAR:
A. I read it, but again, the data we had available were only available on a calendar year basis.
(1:30 p.m.)
STAMP, Q.C.:
Q. So, would you agree that the question of the calculation of accident year loss ratios is an actuarial exercise?
DR. LAZAR:
A. Yes, but you know, it can all be put on computers. I mean, yes.
STAMP, Q.C.:
Q. You don't need actuaries any more, is that right?
DR. LAZAR:
A. It's an actuarial exercise.

STAMP, Q.C.:
Q. Okay.
DR. LAZAR:
A. Okay.
STAMP, Q.C.:
Q. Yes, I can't put it on the computer and make it happen.
DR. LAZAR:
A. There's no reason to disagree.
STAMP, Q.C.:
Q. I'm going to turn to the questions asked to you, are put you, or put the Campaign for you I guess by IBC. And I'm going to turn to question 1a. And essentially the question—I don't know if that needs to be brought up, but we can, I guess, have it brought up if it's best.
DR. LAZAR:
A. Yeah.
STAMP, Q.C.:
Q. This is IBC questions to the Campaign for Dr. Lazar, and 1 –
MR. FELTHAM:
Q. The questions or the answers?
STAMP, Q.C.:

Q. I'm going to get to both I guess, but I just want to get the question first if we—in case people want to see it. I don't want Mr. Kennedy mad at me. So, I'm sorry, is this IBC? I'm not sure. Yes, here we are.
MS. KEAN:
Q. Yes, sorry.
STAMP, Q.C.:
Q. Thank you. That's right, thank you. So, the question is essentially, "Could you please explain financial year data and accident year data, and why differences in the financial year data should affect an analysis based on accident year data?" That's the question that was asked of you at question 1a, and I can tell what the answer is that you gave. It can be brought up, too, if you wish, but it says, "We relied"—this is 1a. "We relied on financial year data because these were the data provided to us. Over a period of time, any year-to-year differences should net out to zero." When you say, "It was provided to us," who do you say it was provide to you by?
DR. LAZAR:

A. The MSA data.
STAMP, Q.C.:
Q. Oh, it's MSA again, is it? Okay.
DR. LAZAR:
A. And the GISA data we looked up ourselves.
STAMP, Q.C.:
Q. Okay.
DR. LAZAR:
A. I believe, or it was a document sent, but it's—you know, the report that Ms. Elliott referred to in her report.
STAMP, Q.C.:
Q. I want to turn for a moment to PUB, Public Utilities Board Questions, and question number 3. And that question 3 at the bottom of the page I think. Yes, thank you. "As reported by GISA, its accident year 2016 estimate ultimate loss ratio is 87 percent, and as of December 31st, 2017, AUTO 1005. As presented in the Oliver Wynman report, the estimated ultimate loss ratio for accident year 2016 is 85 percent. On page 22, Dr. Lazar and Dr. Prisman state Oliver Wyman's estimate of the ultimate loss ratio for accident year 2016 is out of line with

GISA." And then the question is, "Given that GISA's and Oliver Wyman's accident year 2016 ultimate loss ratio are quite close, explain the basis for this statement." That's 3a. And if I can turn to your response to question 3a, you don't appear to answer the question, Mr. Lazar. You simply refer back to your 74 percent again, don't you?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. They've asked for an explanation, but all you did was repeat the 74 percent.
DR. LAZAR:
A. Well, our comment was there was a significant gap; 74 percent compared to her number of 85 percent.
STAMP, Q.C.:
Q. But they had asked you to explain the difference when it came to this 85 percent versus 87 percent, and you just repeated the 74 percent, is that right?
DR. LAZAR:
A. Well, we interpreted that question to refer

to the difference between the GISA number and this 87 percent number.
STAMP, Q.C.:
Q. I think they were drawing your attention to the fact that the 85 and 87 percents were so close. Were they not doing that?
DR. LAZAR:
A. That's not how I interpreted the question.
STAMP, Q.C.:
Q. Okay. In 3b you are asked by the Public Utilities Board, "In comparing loss ratio findings, explain what consideration Dr. Lazar and Dr. Prisman gave to the differences in accident year versus calendar year definition of loss ratios." And there's an answer to that given –
DR. LAZAR:
A. We did not answer that.
STAMP, Q.C.:
Q. Oh, you did.
DR. LAZAR:
A. Uh?
STAMP, Q.C.:
Q. You give an answer. It's at—in your responses.

DR. LAZAR:
A. I refer to the answer to 1a.
STAMP, Q.C.:
Q. Yes, but I'm looking at your response to question 3 –
DR. LAZAR:
A. I don't know what the difference would be between calendar and financial year, year by year, since we didn't have sort of the calendar and accident year because we didn't have the accident year data. So -
STAMP, Q.C.:
Q. I'm sorry, what did you say again? I'm sorry, Mr. Lazar.
A. Okay, I think your question was—sorry, I'm going to refer back to your—"In comparing"—yes. "What consideration"—"gave to the differences"—we did not give any because we did not have the accident year data. Okay. You said the data we used was annual data?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. And do you not accept that there's an important distinction between annual year,

calendar year, versus accident year?
DR. LAZAR:
A. Undoubtedly, there will be timing issues. There will be differences, you know. Can I predict what they might be from year to year; no, I can't, I don't know.
STAMP, Q.C.:
Q. I'm going to just ask you to – we're going to turn to page 109 in Ms. Elliott's presentation on the 6th of September, please. I'm sorry, September 6th, Ms. Elliott's transcript. Sorry about that.
MS. KEAN:
Q. Page?
STAMP, Q.C.:
Q. Page 109. Can you see that, Mr. Lazar?
DR. LAZAR:
A. Yes.
STAMP, Q.C.:
Q. So Ms. Elliott says, "The information that's provided where we do our analysis of estimating what the ultimate losses will be is provided by coverage on an accident year basis, and we also as part of the review process wanted to review the coverage

information that is only available by accident year, and it would be the standard way to review pricing review work is on an accident year basis. So when companies submit rate applications, it's using accident year data, and so this review was looking at a hindsight review of the return on equity that was achieved and measuring that against is a 10 percent target that would be allowed in rates, and that is all done on an accident year basis. So the detailed data is available by accident year. If you look at the calendar year data, it's done on a higher level, so it's third party liability accident benefits and all other coverages combined. It doesn't have the same detail as the accident year data does, and also the calendar year data is net of reinsurance arrangements, whereas when we're looking at pricing, it's all done before any financial reinsurance, and that's done kind of after the fact by the financial departments in insurance companies". Can you respond to that? Do you have anything to say to that observation that Ms. Elliott has

made about why it's important to use
accident year and not calendar year?
DR. LAZAR:
A. Again my response will be two-fold. One, I'll accept there are going to be, obviously, differences in whatever analysis you want to undertake, and, you know, I have no reason to quarrel with this, and my second comment is, I refer you back to my dissertations that I've repeated several times before, and no need to repeat it now.
STAMP, Q.C.:
Q. Thank you. I'm going to turn for one moment to a report that you prepared for the Ontario Trial Lawyers.
DR. LAZAR:
A. Yeah.
STAMP, Q.C.:
Q. It was done April, 2018. You may recall all of that.
DR. LAZAR:
A. Yeah, well, you're assuming my memory is better than it is, thank you.
STAMP, Q.C.:
Q. It's just April.

DR. LAZAR:
A. Um?
STAMP, Q.C.:
Q. It's only just April.
DR. LAZAR:
A. Thank you for giving me the benefit of the doubt.
STAMP, Q.C.:
Q. When that shows up, turn to page six, if I can, please. This is a discussion on ROE, as you'll see in a moment when it comes up, page 6, the bottom of the page, please. Thank you, and you'll see this last full paragraph. It says, "Several years ago my colleague at the Schulich School of Business, Professor Eli Prisman, and I, were retained by FSCO to determine whether the 12 percent benchmark continued to be appropriate in light of the changed financial and economic environments. In our study for FSCO, we estimated ROE caps for 2013 ranging between 4.2 percent and 5.3 percent based on capital asset pricing model". Now were you asked by the Public Utilities Board in their questions whether

you could tell of any jurisdiction that used that model to do ROE for auto insurance?
DR. LAZAR:
A. Other jurisdiction?
STAMP, Q.C.:
Q. That used that model for automobile insurance?
DR. LAZAR:
A. I can sort of go back to the work we did for the Ontario Energy Board, and when we looked at other jurisdictions, Canada, US, there were several in the US that were using this model for regulating electrical utilities.
STAMP, Q.C.:
Q. Okay, electrical utilities, sure, but I'm asking whether you –
DR. LAZAR:
A. For the automobile insurance, FSCO never asked us to do this, so we never did it for them. I've never followed up and looked at it.
STAMP, Q.C.:
Q. But were you asked by the Board here whether that approach was followed by any other rate regulator?

DR. LAZAR:
A. That was one of the questions.
STAMP, Q.C.:
Q. And did you have an answer?
DR. LAZAR:
A. I don't know.
STAMP, Q.C.:
Q. Of any?
DR. LAZAR:
A. No, no, I don't know if any are using it.
STAMP, Q.C.:
Q. Thank you, okay. Now to come back to what you said here, you recommended to FSCO – I take it this is a recommendation to FSCO, is that what you were saying?
DR. LAZAR:
A. At that time, yes.
STAMP, Q.C.:
Q. And when I look at this paragraph, we saw on your CV some reference to a 2015 report. Is that what you mean by several years ago?
DR. LAZAR:
A. Where is this several years ago?
STAMP, Q.C.:
Q. In the part – you said several years –

DR. LAZAR:
A. Oh, FSCO.
STAMP, Q.C.:
Q. I'm just wondering if you –
DR. LAZAR:
A. I think we did the work 2013.
STAMP, Q.C.:
Q. You had a report or something in your CV that spoke about a 2015 rate of return equity discussion for, I thought, FSCO. I'm wondering is what you're referring to –
DR. LAZAR:
A. There was a publication in 2015.
STAMP, Q.C.:
Q. Okay, is that the one?
DR. LAZAR:
A. No, but this FSCO is the work we actually did for FSCO.
STAMP, Q.C.:
Q. All right.
DR. LAZAR:
A. It wasn't published. It was internal to FSCO.
STAMP, Q.C.:
Q. Thank you. So in any event, you

recommended, is that right, to FSCO that it be capped between 4.2 and 5.3?
DR. LAZAR:
A. No, we said those are the numbers we generated. What we recommended to FSCO is if they're going to use this model, then start it off as a ten year rolling average, so either you can go back and correct it, or use your 12 percent, which fell to 11 percent, and then just adjust annually from that point onwards.
STAMP, Q.C.:
Q. And do I understand from your paragraph above that FSCO did not adopt your recommendations?
DR. LAZAR:
A. Well, they didn't.
STAMP, Q.C.:
Q. I just want to read your answer to the question I put to you a moment ago about the methodology, CAPM. Your answer at number five is, "There are no jurisdictions in Canada that rely on the methodology that 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 ROE's for the regulated local electric utilities, the regulators succumbed to the pressures of the regulated industries". I take it that means you don't know of any where this is done for auto insurance?
DR. LAZAR:
A. I don't know.
STAMP, Q.C.:
Q. Thanks, Mr. Lazar.
DR. LAZAR:
A. But I know what happened in Ontario.
STAMP, Q.C.:
Q. Thanks very much. That's all the questions I have, thank you.
DR. LAZAR:
A. Okay.
CHAIR:
Q. Consumer advocate.
BROWNE, Q.C.:
Q. Thank you, Chair. Thank you, Dr. Lazar. Dr. Lazar, can we go to page 17 of your

evidence.
STAMP, Q.C.:
Q. Evidence? Report?
BROWNE, Q.C.:
Q. Yeah, the report of July, 2018.
DR. LAZAR:
A. Yeah.
BROWNE, Q.C.:
Q. Okay, at page 17, and we see here sort of the genesis of where the rate of return comes from, which we're referring here, and we see down below in the 2005 decision for automobile insurance, PUB stated, and this is our PUB, Dr. Kalymon, I assume that's "Dr. Basil Kalymon, recommended a target ROE for setting automobile insurance of 9 to 10 percent. "According to Dr. Kalymon, current 30 year Canada Bond rates were at around 5.3 percent, and 10 year Canada Bond rates were at 4.5 percent. Given that the long term market risk premium based on previous studies is around 4.6", that's combined the two, I guess, "and that the beta risk of insurance operations is around 1, Kalymon stated that the cost of equity capital for

setting automobile insurance rates should be at 9.63 percent.

BROWNE, Q.C.:

Q. "And in considering the issue of the appropriate ROE for automobile insurance benchmark rates in the Province, the Board found Dr. Kalymon's evidence and testimony most instructive and compelling" and went on, "the Board finds that an ROE of ten percent is reasonable for the use in determining the 2005 benchmark rates for automobile insurance."

Now, what are – this was 2005. Can you give us generally what happened to the 30-year Canada bond rate after that period and indeed the ten-year Canada bond? Can you give us some history of that?

(1:45 p.m.)

DR. LAZAR:

A. Let me just go to – what rate did we use here. Okay. We wouldn't use either of those, but nevertheless what happened from 2005 to onwards, especially following September 2008 with the financial market collapse in prices, that interest rates,

short, medium and long term collapsed. They all declined very sharply. And only in the past two or three years, the ten-year and the 30-year bond rates in Canada have edged upwards. They'll still well below the five percent level in that period, you know, pre-2005. Short rates are still at historically low levels and somewhere in the one, one and a half percent range.

BROWNE, Q.C.:

Q. So, therefore, if these are the benchmarks for establishing the ROE and these factors are lower now, certainly you apply them, should we be having an ROE of ten percent? Would that be reasonable in the current environment? Just roughly.

DR. LAZAR:

A. Not at all. Even if you accept Professor Kalymon's estimate of the beta, take his one, he never sort of calculated that. He just assumed that was the right value. We actually did calculate and came up with a lower value. But if you accept that, a value of one, and we've got in our Table 11 what the risk premium has been averaged over

the period 2011 to 2016, it's 5.5 percent, so slightly higher than his number, and if you take the average of the risk-free rate that we use, which is about one and a half percent, add those two together and it gives you an upper limit of seven percent, which is -

BROWNE, Q.C.:

Q. So, the rate of return should have been closer to seven percent based on those values if you were to find -

DR. LAZAR:

A. Just on those values. If you take into account our calculations and that beta, it's closer to six percent.

BROWNE, Q.C.:

Q. Now, there's a general criticism of utility boards across the country, regulators across the country in reference to not accepting the new values of the new economy. I see you're smiling there. In that rates of return seem to be set minus consideration of the long term Canada bonds and the ten-year bonds and indeed the interest rates. Do you have any comments on that?

DR. LAZAR:

A. Yeah. Both in the Ontario Energy Board case and the automobile insurance case with FSCO, the regulated companies argued quite vociferously this would be disastrous, they'll pull out. They're going to leave the industry. They're going to leave the country. And the boards, in both cases, wasn't really willing to challenge them, thinking "what if they do? Then we look rather stupid." So, in both those cases, they capitulated, you know.

Did they do the right thing or not? I'm not going to speculate on that. But that's what happened. Those are the same argument in both cases, different types of companies, different industries, but with a threat that they were going to exit if the returns were too low. I personally didn't think that would happen, but I didn't offer that opinion. I'm not the one that had to make the final decision. And I didn't have to report to political masters. So, it's easy for me to say this is what it should be.

BROWNE, Q.C.:

Q. And there's some thought that follows that that ratepayers haven't got the full value of this changing financial economy because boards have been reluctant to lower rates of return consistent with that economy. Is that a fair comment?

DR. LAZAR:

A. Absolutely, and that was the point I was trying to make in my repeated dissertations why we can quibble the numbers, but at the end of the day, there's a difference between the ROE that was allowed and the ROE that should have been allowed. That's one of the major issues.

BROWNE, Q.C.:

Q. And I know in this particular jurisdiction, at one point, at least for the energy utility, there was an automatic adjustment formula in place back – requested by the utility actually and brought evidence of how it would be more beneficial to us all, in 1998, I do believe, 1999, and indeed, the Board implemented an automatic adjustment

formula based on the long term Canada and the ten-year, an average of those, and plus put three percent on top of that which became the rate of return for the company. It set the range for the rate of return.

And I remember anecdotally, the first year in which it was implemented, there was press releases from the utility saying how pleased they were because their rates went up. Well, lo and behold, then we got the new economy and all of a sudden, the automatic adjustment formula was no longer applicable to the utility. They said "we can't make any money like this", when actually if it had to stay in place, we probably wouldn't be talking about the overcompensation and the rate of return of the insurance industry and perhaps, no doubt, of the utilities.

Do you have any comment on the implementation of an automatic adjustment formula as opposed to going through these processes, based on the long term rate or the short term rate? Because the Canada bond really is what is the distinguishing

feature.

DR. LAZAR:

A. I'm a firm supporter of simplicity.

BROWNE, Q.C.:

Q. Yes.

DR. LAZAR:

A. Hearings, there are times when they have values. Most often they're a monumental cost burden to everybody and simply a waste of time. I'm not a fan of meetings. I think issues can be resolved very quickly. So, is an automatic formula the way to go? Yes. You're going to need a hearing to determine what that formula should look like, what should go into it, and then it's on auto pilot.

BROWNE, Q.C.:

Q. Yes.

DR. LAZAR:

A. Period.

BROWNE, Q.C.:

Q. Because it seems to me that the regulators across the country have kowtowed to the regulated by compensating them more in this particular economy. Is that fair comment?

DR. LAZAR:

A. That's been the net result and it's not just Canada, but you see the same thing in the US as well.

BROWNE, Q.C.:

Q. Is there a role for the legislature in this? That the legislature should take note of the situation as it is and that rates could be set based on long term bonds and percentages and for them to give more direction to the regulator when setting rates of return in the interest of consumers generally?

DR. LAZAR:

A. Well, the government appoints the board, gives the board the mandate. Should the legislature pass a law saying there should be a set formula and then it should be on auto pilot thereafter? I think that they should. Then it would be up to the board to again have a hearing and determine the formula and the inputs into it.

BROWNE, Q.C.:

Q. Thank you, Dr. Lazar.

CHAIR:

Q. Any questions?

COMMISSIONER OXFORD:
Q. No.
CHAIR:
Q. Anything -
MR. FELTHAM:
Q. Just one to go back to – I'm not sure we have a fulsome answer on one question that was put to you by Mr. Stamp, Dr. Lazar, with respect to – the questions concerning can we take the numbers from Oliver Wyman, you know, and put those in; that that's somehow going to change your opinion with respect to what the overpayment looks like. And you indicated "well, I've looked more closely at that and I've done some calculations to kind of get a sense of what that might be", and I think it's important that the Board hear from you on that point.
DR. LAZAR:
A. Okay. Again, there's a simple formula for how you define profits, underwriting profits plus whatever investment returns there are. Simple formula for then determining what the return on equity, can play around with it, and what you get then is premiums depending

upon key assumptions, such as operating expense, return investment, return on equity equals some multiple of whatever the claims are expected for that year. So, it's a straightforward exercise. I'm quite happy to sort of write out the formula and send it along to you.
But nevertheless, plugged in that formula and I just did some rough calculations and I said, okay, what if we take the Oliver Wyman assumptions as a starting point this is how premiums should have been set, and I used their expense ratio of 26 percent on average, four percent return on investment, ten percent return on equity. So, that would give us some multiple of premiums to whatever the claims are.
And so, okay, now let's adjust those. Let's adjust – let's take the 26 percent expense ratio, four percent return on investment and only change the return on equity. What difference does this make? And the difference is three percent of premium overpayments each year. So, just by

changing return on equity from ten to six percent, accepting everything else in the Oliver Wyman report, we get overpayments of three percent year in year out.
Now, what if we change – reduce the expense ratio? Take the four percent return on investment, the six percent return on equity, but we're also reducing the expense ratio. What is the result? Now you get overpayments of five and a half percent per year. So, change that assumption. Well, now what if we go one step further, change expense ratio, change return on investment to six percent, the return on equity to six percent, what does this do? It increases the overpayments each year by six percent.
So, ranges from three to six percent per year. What are the premiums on average here? They're running around 300 million. Apply these numbers. So that means overpayments of 9 to 18 million per year at the current premium rate. Plain and simple. Doesn't matter what the end profitability is of the insurance companies. If you plug in different expense ratios, different return

on investments, more importantly different return on equity, you're going to get overpayments. Everything else just becomes irrelevant noise.
MR. FELTHAM:
Q. Thank you.
CHAIR:
Q. Thank you, Mr. Feltham. Thank you very much, Dr. Lazar.
DR. LAZAR:
A. Oh, my pleasure.
CHAIR:
Q. Wish you safe travels home this evening. We're back here tomorrow morning at nine with Dr. – please help me with his pronunciation.
MR. FELTHAM:
Q. Madam Chair, I think 9:00 we're going to begin with the Consumer Advocate presenter.
CHAIR:
Q. Oh, we switched?
MR. FELTHAM:
Q. Yeah.
CHAIR:
Q. Okay. All right.

MR. WADDEN:
Q. Yeah, if that's okay, Madam Chair. What we'll do is we'll start with Mr. Donaher at nine. I know the Campaign was interested in knowing how long that would take.
CHAIR:
Q. Absolutely.
MR. WADDEN:
Q. But I mean, Mr. Donaher is not putting forward any contentious information or evidence, I don't anticipate, so I think by the time we're finished with him, assuming there's some questions from around the room, including yourselves, I suspect an hour would be find for Mr. Donaher, if they want to give Mr. Blidook some idea of when to come in.
CHAIR:
Q. Will that be enough time to deal with Dr. Blidook?
MR. FELTHAM:
Q. I understand Professor Blidook will be here at 9:30.
CHAIR:
Q. Okay.

MR. FELTHAM:
Q. So, he has some flexibility.
CHAIR:
Q. That does give us time to finish?
MR. FELTHAM:
Q. I hope so.
CHAIR:
Q. Okay. All right. Have a nice evening everyone.
UPON CONCLUSION AT 2:00 P.M.

CERTIFICATE

I, Judy Moss, hereby certify that the foregoing is a true and correct transcript in the matter of the 2017 Automobile Insurance Review heard before the Board of Commissioners of Public Utilities, 120 Torbay Road, St. John's, Newfoundland and Labrador and was transcribed by me to the best of my ability by means of a sound apparatus.

Dated at St. John's, Newfoundland and Labrador this 13th day of September, 2018

Judy Moss

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