August 16, 2021

Cheryl Blundon, Board Secretary
NL Board of Commissioners of Public Utility
120 Torbay Road
P.O. Box 21040
St. John's, NL
A1A 5B2

RE: FA NL **Category 2 Private Passenger Vehicles Rate Application – OW Private Passenger Vehicles Report of Finding** – Response to Report dated August 9, 2021

Dear Ms. Blundon:

Facility Association ("FA") received a copy of the August 9, 2021 Oliver Wyman ("OW") report *"Review of Mandatory Filing submitted by Facility Association: Private Passenger Vehicles"* (the "PPV Report") with a request to provide comments (if any) to the Board of Commissioners by August 16, 2021. FA appreciates the opportunity to comment, as presented on the pages that follow, and is happy to provide any additional clarification as needed with respect to our comments.

The OW PPV Report contains 16 findings related to the rate level changes (listed in bullet form on pages 4 through 6), of which two are discussed but only one in detail:

- Profit Provision
- Return on Investment Income.

Before addressing it, we would like to remind the Board that our position continues to be that residual market volumes (both the Risk Sharing Pools and the residual market segment) should be as small as possible.

There are two reasons for this:

1. First, a small residual market is ongoing evidence that the market is competitive, and that consumers are successfully finding coverage in a market they choose.
2. Second, we believe those consumers are best served by companies competing directly for their business without the need to calculate the impact arising from their compulsory participation in residual market mechanisms. That is, residual market mechanisms should be small enough that

their presence in a compulsory auto insurance jurisdiction should be "incidental" to a company's competitive participation in that jurisdiction.

It is our strong belief that companies competing directly for their business in an environment where those companies do not have to frame their business decisions based on potential financial impacts from residual market mechanisms best serve consumers.

FA's primary concern is always the protection of market availability, and the best guarantee of market availability is a healthy, competitive regular market.

Profit Provision

OW states in its PPV Report "any changes to the profit provision is a policy issue for the Board", we agree with the comment, and we believe the Board should allow FA's rates including profit provision.

As we responded to the June 25, 2021 Public Utilities Board Request for Information ("NLPUB RFI"):

> *With the upcoming implementation of IFRS 17, a thorough legal review of Facility Association has been done to understand the treatment of FA residual mechanisms within the automobile insurance ecosystem. The review confirmed that FARM business is collectively written by FA members i.e. members are the counterparty to the insurance contract written via the Servicing Carriers. FA is the "conduit" which facilitates the sharing of the risk*.
>
> *FA is an unincorporated non-profit association; the results of the insurance written through Servicing Carriers, on behalf of members, is shared within the insurance industry. This means that profits shall be credited or distributed to each member and losses shall be charged against or collected from each member in accordance with the member's appropriate participation ratio as determined in accordance with the Plan of Operation. As such, all the member insurers share FA's profits or losses.*
>
> *In summation, while FA is a non-profit association, FA members whose capital supports the business written through FA are writing business for a profit. In fact, in NL, they are allowed/subject to a 5-6% RoP benchmark i.e. "…the Board will generally accept as reasonable in rate filings is 5%-6%".* ***Consequently, FARM business should also be allowed a profit provision as it is collectively written and supported by FA members.*** [Emphasis added]

Additionally, our answers to Question PUB-FA-008 of the NLPUB RFI included the comparative premium information completed by the Agent/Broker in 2020. It indicated that, for the 21% of business placed with FA due to premium being lower other markets, the premium difference was on average $631.48 lower than the next available standard market carrier.

Considering that we just completed our review for 2021-Q1, we will take the opportunity to share the results. During 2021-Q1, Agent/Broker indicated that 24% of business placed with FA was due to premium being lower than other markets with an average premium difference of $890.37 to the next available standard market carrier.

Both indicators have been increasing:

- % of business placed with FA due to premium lower than other markets from 21% to 24%, and;
- the average premium gap between FA's rates and the next available standard market rates from $631.48 to $890.37 (increase of +41%).

We believe that allowing FA to include a profit provision in its rates would reduce this gap and increase market participation and availability of insurance coverage.

Considering this, we respectfully request the Board to allow a profit provision to be included in the FA's rates.

Return on Investment Income

Considering the uniqueness of FARM funds i.e. on-demand callability and fund segregation as defined in **FA Bulletin F05-031** (see **Appendix A** for excerpts of this bulletin), we believe it is reasonable to assume that the funds held by FA's member companies backing FARM business would be invested in less risky assets than their regular business.

Even though FA is not monitoring/auditing how members are investing funds related to either their FA business or (obviously) their regular business, we believe that, considering the level of expertise in our members' investment teams, we can presumably assume that the unique nature of FARM funds (as explained above) are taken into considerations when invested.

Therefore, at minimum, equity investments should not be considered in the RoI used in pricing FARM business and the OW stated average pre-tax return on investment rate for automobile insurers operating in NL (2.00%, 3.61%, and 3.48% for, 2018, 2019 and 2020, respectively; an average of 3.03%) should not be the basis to select an appropriate RoI for FARM business.

Since the annual *Report on Canadian Economic Statistics* from the Canadian Institute of Actuaries was recently released, we would like to take this opportunity to demonstrate to the Board that our proposed rate change of **+8.49%** is reasonable. You will find below a summary of different overall rate indications with the corresponding RoI methodology and value. Please note that all other assumptions were kept as per our original rate filing. Definitions and calculations of the different RoI can be found in **Appendix B**.

RoI Methodology	**RoI**	**Overall Rate Indication**
Government Bond (2019) – used for rate filing	+1.44%	+10.7%
Government Bond (2020)	+0.36%	+13.9%
Risk-Free (June 2021)	+0.45%	+13.7%
Average Industry returns a.k.a NBIB approach (2020)	+1.32%	+11.1%

Finally, our preferred approach would be one that would include bonds from federal government, provincial government, municipal, public authority and School (lines 09, 19 and 29 as per MSA Researcher P&C Software consolidated page 40.22) but would exclude Corporate Bonds. However, we did not find yet the proper source(s) to derive the RoI from this methodology but we would assume that it would be between the ones derived by the Government Bond (+0.36%) and the NBIB (+1.32%) methodologies.

If you wish to discuss this further, please do not hesitate to contact me via email at pgosselin@facilityassociation.com or by phone at 416-644-4968.

Sincerely,

Philippe Gosselin, FCAS, FCIA
VP Actuarial & CRO

Appendix A - Excerpts of **FA Bulletin F05-031** (TRANSFER OF FACILITY ASSOCIATION RESIDUAL MARKET (FARM) RELATED FUNDS TO MEMBER COMPANIES):

1. ***Purpose of Transfer of Funds***
   a. *… **FARM policyholder funds held by Members will eventually need to be returned to the Facility Association to enable it to pay the policyholder claims to which these funds relate.***

2. ***Timing of Repayment to the Facility Association***
   a. *While the Facility Association will make every effort to provide a full quarter advance notice before requesting the return of any of these funds from Members, this may not always be possible **since cash flows can be quite volatile within the residual markets. All members must remain prepared to return funds within the timeframe requested by the Facility Association**, since all requests will be solely as a result of an impending need to pay claims and/or return unearned premiums to policyholders insured through the FARM.*

3. ***Accounting for this Transfer of Funds***
   a. *Be sure to **maintain the balance "FARM Funds due to Facility Association" separately in your books** since there should be no interaction whatsoever with any other Facility Association account maintained within the books of your company. Facility Association will administer both the payment of these funds to your company and the eventual recollection of same from your company, i.e. to allow Facility Association to pay the FARM policyholder claims to which these funds relate.*

Appendix B – Definitions and calculations of the RoI methodologies

1. Methodologies:

a. **Risk-free methodology** gives consideration to several factors, including:

   i. Recent Bank of Canada selected marketable bonds average yields for 1-3 year, 3-5 year, 5-10 year and over 10 year
   ii. Recent Bank of Canada selected treasury bill yields for 3 months
   iii. Average investment duration based on the claim payment patterns
   iv. Estimated investment expenses.

   Source: http://www.bankofcanada.ca/rates/interest-rates/lookup-bond-yields/

b. **Government Bond methodology** gives consideration to several factors, including:

   i. Government of Canada bonds average yields for 91 day, 1-3 year, 3-5 year, 5-10 year and over 10 year
   ii. Average investment duration based on the claim payment patterns
   iii. Estimated investment expenses.

   Source: Canadian Institute of Actuaries, Report on Canadian Economic Statistics, 1924-2019 ***and*** *1924-2020, Table 4A*

c. **Average Industry returns methodology (NBIB approach)** gives consideration to several factors, including:

   i. Government of Canada bonds average yields
   ii. Corporate Bonds average yields
   iii. Industry distribution of Government and Corporate Bonds
   iv. Estimated investment expenses.

   Sources:

   - *Canadian Institute of Actuaries, Report on Canadian Economic Statistics, 1924-2020, Tables 3A and 4A*
   - *MSA Researcher P&C Software. Consolidated page 40.22*

2. Calculations:

a. Government Bond (2019)

Current Government Bonds Yields at :2019 - Report on Canadian Economic Statistics, 1924-2018, Table 4A						wgted avg
2019	1.67	1.60	1.52	1.53	1.73	1.59
Payments by Development Age -PPV	2,572	8,565	2,861	2,252	273	16,523
weights:	16.0%	52.0%	17.0%	14.0%	1.0%	
avg maturity:	3.0 years		(weighted based on claims payment patterns)			
					Selected Gross Yield:	**1.59%**
					Investment Expenses (rounded):	0.15%
					Selected Net Yield:	**1.44%**

b. Government Bond (2020)

Current Government Bonds Yields at :2020 - Report on Canadian Economic Statistics, 1924-2020, Table 4A						wgted avg
2020	0.42	0.48	0.53	0.65	1.08	0.51
Payments by Development Age -PPV	2,572	8,565	2,861	2,252	273	16,523
weights:	16.0%	52.0%	17.0%	14.0%	1.0%	
avg maturity:	3.0 years		(weighted based on claims payment patterns)			
					Selected Gross Yield:	**0.51%**
					Investment Expenses (rounded):	0.15%
					Selected Net Yield:	**0.36%**

c. Risk-free (June 2021)

Current Risk Free Yields (basis points): BoC at 2021-06-30 http://www.bankofcanada.ca/rates/interest-rates						wgted avg
6/30/2021	0.14	0.44	0.87	1.28	1.77	0.60
Payments by Development Age -PPV	2,572	8,565	2,861	2,252	273	16,523
weights:	16.0%	52.0%	17.0%	14.0%	1.0%	
avg maturity:	3.0 years		(weighted based on claims payment patterns)			
					Selected Gross Yield:	**0.60%**
					Investment Expenses (rounded):	0.15%
					Selected Net Yield:	**0.45%**

d. Average Industry returns a.k.a NBIB approach (2020)

						wgted avg	Weight
Government Bonds Yield for Yr: 2020	**0.42**	**0.48**	**0.53**	**0.65**	**1.08**	**0.51**	**57.0%**
Corporate Bonds Yield for Yr:2020	**2.74**	**2.74**	**2.74**	**2.74**	**2.74**	**2.74**	**43.0%**
Report on Canadian Economic Statistics, 1924-2020, Table 4A and Table 3A							
Payments by Development Age -PPV	2,572	8,565	2,861	2,252	273	16,523	
weights:	16.0%	52.0%	17.0%	14.0%	1.0%		
avg maturity:	3.0 years		(weighted based on claims payment patterns)				
					Selected Gross Yield:	**1.47%**	
					Investment Expenses (rounded):	0.15%	
					Selected Net Yield:	**1.32%**	