(9:10 a.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: Good morning, ladies and gentlemen.

MR. O'FLAHERTY: Good morning.

MR. SAUNDERS, PRESIDING CHAIRMAN: And those amongst you who are superstitious. Nice morning out there this morning. I understand we have a few preliminary matters, so Mr. Whalen?

MR. WHALEN, Q.C.: Thank you, just matters of information, Mr. Chairman and Members of the Board. Just to let everyone know, it appears as though we will have that information requested by the Intervenor, hopefully by Monday, certainly no later than the beginning of the hearing on Tuesday morning, and that will be circulated as soon as it is available.

MR. SAUNDERS, PRESIDING CHAIRMAN: Very well.

MR. WHALEN, Q.C.: Also, arising out of the request of the Board at the beginning of the hearing, we will be calling Mr. David Simpson, the President and CEO of Facility Association at the appropriate time. I think it will probably be after the experts have given evidence, and we understand that a service carrier and brokers will be available as witnesses to the Board on this, to comply with the request of the Board, and we don't have names or dates arranged on that, but we'll work with Counsel for the Board and get that nailed down, and of course, notify the Board and others as soon as that's done.

MR. SAUNDERS, PRESIDING CHAIRMAN: Thanks, Mr. Whalen, anything else?

MR. WHALEN, Q.C.: That's all.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, anything Mr. O'Flaherty?

MR. O'FLAHERTY: Nothing, Mr. Chairman.

MS. NEWMAN: Mr. Chairman, just one item here, I notice that the Board has prepared copies of the executive summaries of the report that was referred to yesterday, and I guess that would be information item number one, just so that the parties have a copy of that.

MR. SAUNDERS, PRESIDING CHAIRMAN: Are you distributing ...

MS. NEWMAN: Yes, we are, yeah.

MR. SAUNDERS, PRESIDING CHAIRMAN: Are you marking that?

MS. NEWMAN: Information number one.

MR. SAUNDERS, PRESIDING CHAIRMAN: Information one. Okay, Mr. O'Flaherty, are you ready to continue? Good morning, Mr. Pelly.

MR. PELLY: Good morning, Mr. Saunders.

MR. SAUNDERS, PRESIDING CHAIRMAN: It wasn't that I didn't see you there, I've got other matters. How are you this morning?

MR. PELLY: I'm a little bit hoarse, but fine, thank you.

MR. SAUNDERS, PRESIDING CHAIRMAN: You were at a hockey game or something, were you?

MR. PELLY: I must have been *(laughter)*.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, Mr. O'Flaherty.

MR. O'FLAHERTY: Thank you, Mr. Chairman. I'm going to turn now to the area of loss development, Mr. Pelly.

MR. PELLY: If it's convenient, Mr. O'Flaherty, I can report back on those two items that you asked me to confirm yesterday?

MR. O'FLAHERTY: Certainly.

MR. PELLY: Or at a later point, whatever suits you.

MR. O'FLAHERTY: It's okay, Mr. Chairman, whichever ... if you want to deal with the issues from yesterday, we might as well do that.

MR. SAUNDERS, PRESIDING CHAIRMAN: It would probably be best to have it cleaned up.

MR. O'FLAHERTY: Yes, sure.

MR. PELLY: My recollection of the first item was to confirm whether or not any changes arose in the assumptions or methodologies for developing the indications as a result of the consultation with the actuarial committee of Facility Association. The answer to that question is no. The second confirmation which you requested was whether or not any changes to the indications arose after my presentation to the board of directors of Facility Association, and the answer to that is yes, and the modification related to the proposed effective date for the indications which led to an adjustment of the duration of the trend factor. Originally it was proposed for a slightly later effective date, and it was pulled back to the one used in the application as filed, which was February 1st, 2003.

MR. O'FLAHERTY: Thank you, Mr. Chairman, I'm going to turn to the issue of loss development now, so that we can all be, have the same material in front of us, I'd ask you to have BGP-3 at page 12, which is the coloured charts you showed yesterday. I don't think it's necessary to put them on the screen or anything like that.

MR. PELLY: I have a black and white version, but that should do me.

MR. O'FLAHERTY: Pardon me?

MR. PELLY: I have the black and white version, but that should do me.

MR. O'FLAHERTY: Okay, I'm going to be referring to the coloured one. I don't think it makes any difference in terms of where the points lie. The second thing I'd ask you to have is the 2002 filing, the filing from this year that the Board is now considering.

MR. PELLY: Yes, okay.

MR. O'FLAHERTY: And as well the 2001 filing.

MR. SAUNDERS, PRESIDING CHAIRMAN: Just a moment, Mr. O'Flaherty, I'm just checking to see if we have the 2001 filing here. Yes. You're talking about the 10th of May, 2001.

MR. O'FLAHERTY: Yes, Mr. Chairman.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MR. O'FLAHERTY: And in that document I'll be referring to, if you could open on page 4.2, which is in the schedule, Schedule 4, in Appendix A, and if we can just leave it there on that, with that page open so that ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, fine, I have that. Now there's another, there's a supplement there, it's dated the same, which is the 10th of May, 2001, labelled "Selected Miscellaneous Vehicles", are you dealing with any of that?

MR. O'FLAHERTY: No, I will not be.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, very well, Mr. O'Flaherty, continue on.

MR. O'FLAHERTY: Okay, thank you. Mr. Pelly, I'd like to start with a couple of items I think we can both agree on. Do you agree this is a topic of major importance to the indications for the private passenger vehicle rates?

MR. PELLY: Yes, I do.

MR. O'FLAHERTY: And would you also agree that the changes in the selected loss development factors from last year's filing are significant?

(9:15 a.m.)

MR. PELLY: Give me a moment, and I'll answer that.

MR. O'FLAHERTY: I suppose this is more of a general observation, at the bottom of page five of this year's filing, we have a statement here that says, from these exhibits, and these are the exhibits attached to the filing, we observe that the development assumptions for incurred losses at 31 December, 2001, are generally higher than those at 31 December 2000, due to the greater than expected emergence *(phonetic)* on older accident years during 2001.

MR. PELLY: I agree with that statement.

MR. O'FLAHERTY: Okay, I expected you would, so would you agree then that in that context at least, that the changes in the selected loss development factors from last year's filings are significant?

MR. PELLY: The difficulty I'm having in giving you a quick answer of yes arises because not all of the significance that's referenced in that part of the text is strictly due to the loss development factors.

MR. O'FLAHERTY: Okay.

MR. PELLY: It also arises because of the claims experience.

MR. O'FLAHERTY: That's fair enough, I'll rephrase the question then because we are going to be in ... this is going to be a long topic and I don't want to get hung up on semantics. Just go to page 4.4 of the actual filing, this year's filing. Do you have that?

MR. PELLY: I do.

MR. O'FLAHERTY: Now, you've indicated, and I'm paraphrasing from the narrative that you've added in an extra line here to show us the 2000 loss development factors, well the loss development factors based on 2000 AIX information, and that would be the line which would be third from the bottom on this particular page, I take it, okay, and directly below that it's going to be the selected factors for this year.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, so there is a pattern of increase on the selected for this particular filing over last year's filing, is that correct?

MR. PELLY: No, the twelve 2000 loss development factors ...

MR. O'FLAHERTY: Yes.

MR. PELLY: Relate to our analysis of the 2000 AIX.

MR. O'FLAHERTY: Sorry, exactly, you're correct, that's right, and it's as a result of the emergence in the last year, there is a change in the loss development factors from the 2000 AIX based on this year's review of that data. Sorry, based on the 2001 AIX.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, it's correct, I need to be very specific on this. Okay, now these new or updated selections are ultimately responsible for a large portion of the increase to the indicated rates, are they not?

MR. PELLY: I would agree.

MR. O'FLAHERTY: Now, in terms of just basically orienting myself for the process, we're at the stage of the process where you're taking accident year reported losses, or sorry, loss costs, and you're developing them to the expected ultimate values, is that correct?

MR. PELLY: Technically we're applying them to losses before they get converted to loss cost but it's a minor point, yes.

MR. O'FLAHERTY: Okay, and you're doing that by using a multiplicative factor.

MR. PELLY: Correct.

MR. O'FLAHERTY: Alright, so in a simple example, you've got reported loss costs of $100 and you're going to select a multiplicative factor of 1.5 and you're expected ultimate value is $150.

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, so that's the type of analysis we're going to be looking at, and the actual, the numbers for this incurred projection are at the top, the incurred loss costs, incurred amounts?

MR. PELLY: The incurred amounts, yes.

MR. O'FLAHERTY: I'm speeding along here, I should slow down, okay, I'll take my time through this. I'm trying to balance effectiveness with getting the message across, okay, so that's, that information at the top of this particular page, is that referred to as a loss triangle?

MR. PELLY: Very good, yes.

MR. O'FLAHERTY: So the change between the figures in the columns as they head out to the right, those correspond to the actual multiplicative factor that you can find below in the next set of information which is called development factors, is that correct?

MR. PELLY: That's correct.

MR. O'FLAHERTY: So my 1.5 example is the 1.41, 1.12, etcetera, etcetera, that are found throughout that next triangle.

MR. PELLY: Well, almost. The 1.5 example I think you were trying to use would represent a factor to ultimate.

MR. O'FLAHERTY: To ultimate yes.

MR. PELLY: And each of the columns that you see here is an interval factor, so it takes you from one age to the next age. To create a factor to ultimate you need to accumulate the interval factors, but basically, yes.

MR. O'FLAHERTY: Okay, and you're going to be looking at a method of selecting the appropriate loss development factor for each of the vertical columns, which are the time intervals as we move through this chart on the very bottom, is that correct?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, I hope that was of some assistance to ... now, would you agree that the Board's actuaries use a standard approach to selecting loss development factors, which is a five year weighted average?

MR. PELLY: It's an approach that's not uncommon, if that makes it standard, sure.

MR. O'FLAHERTY: Okay, and I'll be very specific with my question, they don't make any ... when they're reviewing these vertical columns, they use a five year weighted average for each of the vertical columns?

MR. PELLY: That's my understanding.

MR. O'FLAHERTY: Okay, so when I say standard, they do not use, there's no random selections, they use one approach for all of the columns?

MR. PELLY: That's true.

MR. O'FLAHERTY: Okay.

MR. PELLY: That's what their recommendation is.

MR. O'FLAHERTY: Alright, now in terms of the way that you are going to ... so, and just so that ... I may be being a bit bedantic *(phonetic)* here, but in other words, some of the different possibilities might be in the second band of information from the bottom, you have your last three years, your last five years, all years, that sort of ... that gives you an idea of an averaging approach to the information, correct?

MR. PELLY: Different approaches to ...

MR. O'FLAHERTY: Right, now the one that they use is not here, it's not listed. They use a weighted five year approach.

MR. PELLY: That's the ...

MR. O'FLAHERTY: Oh, it is there, yeah, the 1.2016.

MR. PELLY: The sixth one down.

MR. O'FLAHERTY: Okay, and is that, does that take into account the weighting that they use, you know, for example, 30 percent on the last year, 20 percent, etcetera.

MR. PELLY: I believe that's the case, yes.

MR. O'FLAHERTY: Okay, you believe that's the case, okay. So then your approach is not actually listed here, is it? There's not a separate category showing your approach?

MR. PELLY: Well, our approach involves the application of actuarial judgement which you can't program, so ...

MR. O'FLAHERTY: Right.

MR. PELLY: That's true.

MR. O'FLAHERTY: Exactly, okay, so if we were to look through all the exhibits, and I'm just going to concentrate on third party liability, okay, because that's the major, that's where the major differences are going to be found at the end of the day, correct?

MR. PELLY: Yeah, it's an important coverage.

MR. O'FLAHERTY: Okay, but there are similar charts for each of the difference coverages for private passenger vehicle?

MR. PELLY: That's true.

MR. O'FLAHERTY: Okay, now if we were to look through all of these different exhibits which I have, it seems to me that as a general rule, or no, that's not even specific enough, that if one approach were selected more than others by your particular company, it would be a five year average approach, would you agree with that?

MR. PELLY: That is true, yes.

MR. O'FLAHERTY: Okay, so then the five year weighted average is selected for the vertical columns by the Board's actuary in all cases for all coverages?

MR. PELLY: I believe that's the recommendation.

MR. O'FLAHERTY: Okay, and you have a, we'll call it a default or dominant approach of five year averaging.

MR. PELLY: Yes.

MR. O'FLAHERTY: And but you vary from that approach for particular columns, vertical columns, as you review them.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, now would you agree that your selected loss development factors for BI are selected more judgementally than either the five year weighted approach of the Board or even your own general five year approach?

MR. PELLY: It involves the application of judgement, yes.

MR. O'FLAHERTY: Okay.

MR. PELLY: That's fundamental actuarial work.

MR. O'FLAHERTY: Okay, but just in terms of ... at the very highest level, your approach is by its very nature more random than either the Board's approach or the approach of the five year averaging?

MR. PELLY: No, I would disagree. It's not random at all, it's directed. It's specifically focused with the objective of dealing with the data properly.

MR. O'FLAHERTY: So you're aiming for precision or responsiveness, I take it, when you take an approach, you're going to deal with every single column differently?

MR. PELLY: Well, as you know, we haven't dealt with every single column differently. We look at each column with the objective of identifying the need. In this instance, dealing with data exclusions, we're looking for the need to exclude a data point because it isn't contributing to the process of developing an expectation for the future, or it's distorting the process of selecting a development expectation for the future.

MR. O'FLAHERTY: Well, you would acknowledge that in either of the five year averaging approach, or the five year weighted averaging approach to these vertical columns, there are no data points that are removed.

MR. PELLY: That's very true.

MR. O'FLAHERTY: Now the report of the Board's actuary makes the point that there is a pattern within the third party liability, bodily injury tort, loss triangles, of selecting, sorry, of excluding the lowest year or even years in each case for bodily injury. Would you agree with that?

MR. PELLY: That happens to coincide with the points that were excluded, yes.

MR. O'FLAHERTY: Okay, so if we then look over, and I hope you have open BGP-3, page 12.

MR. PELLY: I have that.

MR. O'FLAHERTY: In each case, when you are excluding data for the purpose of arriving at an appropriate selection of these vertical columns, for each of these vertical columns, the data points you, that you are removing are the black dots. They are all below the line, in other words, they are below the red line, would you agree with that?

MR. PELLY: That's true.

MR. O'FLAHERTY: And they are always the lowest point or more than one lowest point in the analysis.

MR. PELLY: I don't think they're always the lowest point. If you look in interval four you can see there is one data point below the black dot, although it's older than the latest five years.

MR. O'FLAHERTY: Fair enough. Let's go back to the loss triangle then. In the first of the, in the first of the vertical columns then we're going to be looking at five years of accident data in each case, correct?

MR. PELLY: I'll be guided by you in that respect, certainly.

MR. O'FLAHERTY: Okay, is that the way in which you were, that you have analyzed it?

MR. PELLY: Well, we look at the entire triangle but we ended up using as a starting point for our analysis, a five year average as we previously established.

MR. O'FLAHERTY: Right, so in the middle of the ... the triangle that deals with development factors, that's the one I'm referring to, Mr. Chairman ... if you look at the first five numbers there, I'm sorry, the bottom five numbers from 2000 back up to 1996, and they are 1.4106, 1.212, 1.558, 1.058, and 1.823, and the selection in this case is your default selection, I've called it, the average of the last five years, is that correct?

MR. PELLY: I think you actually read some of the numbers incorrectly, but in principle, I know what you intended to do and ...

MR. O'FLAHERTY: It's been a long night, am I on the right track?

MR. PELLY: I think you are, yes.

MR. O'FLAHERTY: Okay, so now if we look over at the chart, what you have ... you have no black dot here whatsoever because you have not excluded any of those five numbers.

MR. PELLY: That's correct.

MR. O'FLAHERTY: So, and this is in the, you know, in layman's language, so as far as you were concerned, your analysis was that in each case the data points were within a reasonable approximation of the average, were they? Perhaps I should back up. What's the reason for excluding a data point again, you just mentioned it a moment ago, the rationale.

(9:30 a.m.)

MR. PELLY: We want our, the assumption that we end up with to represent a reasonable expectation for the future, and so we don't want to include data points that lead to a distortion of that.

MR. O'FLAHERTY: Okay, so when you judge that the data point is a distortion then you will exclude that from your particular selection?

MR. PELLY: Sure, yes.

MR. O'FLAHERTY: Okay, I'm just trying to work through in my mind the process that you're going through here, so in this particular case you looked at those five data points for indications, and sorry, loss development factors, and you did not exclude any one of those five, and you included them all and used your five year averaging.

MR. PELLY: That's true.

MR. O'FLAHERTY: And we turn to the next five and these are, and I will read them from 1999 up, 1.1973, 1.0992, 1.2117, 1.1342, 0.9110. Would you agree then in that case, the, the loss development factors selected is the average of the four years which exclude the lowest number, 0.9110.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, and that 0.9110 is the black dot at the bottom of the interval marked two.

MR. PELLY: That's correct.

MR. O'FLAHERTY: So that's the lowest point in the data set of the five that you're considering for your selection.

MR. PELLY: Well, we can, as I said, we consider the whole triangle, but of the five we use as the default.

MR. O'FLAHERTY: Okay, and you consider that to be a distortion?

MR. PELLY: We would exclude it because it's an outlier, yes.

MR. O'FLAHERTY: Now, that black dot in the second interval is when it's ... okay, I'll come back to that. Let's go to the third of the vertical columns, and this is the one that reads 1.0868, 1.0698, 1.0590, 0.9561, 0.9753, and in this case you've selected the average of the last, of the three years which exclude the two lowest numbers.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, and on the chart under the interval four, or sorry, under interval three, that larger black dot has two dots, has two, two ...

MR. PELLY: It's really two black dots.

MR. O'FLAHERTY: It's two black dots, and they're both the lowest black dots.

MR. PELLY: Yes.

MR. O'FLAHERTY: Correct? Alright, and then the next interval is the fourth one, and can I just speed this up a little bit by saying that you've excluded 0.9097, which is the lowest of the five in that case, and arrived at the average of the other four?

MR. PELLY: I believe that's true, yes.

MR. O'FLAHERTY: Is that too fast for the Board?

MR. SAUNDERS, PRESIDING CHAIRMAN: No, I follow you, Mr. ...

MR. O'FLAHERTY: Okay, and that's the black dot at the bottom, sorry, that's the black dot shown there just above the 0.9097, sorry, just above the 0.9 bar, is it? Is that the black dot that's shown just above the ...

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, thank you. If you go to the next one you've chosen a five year average?

MR. PELLY: Yes.

MR. O'FLAHERTY: And in the next one after that you're back to four years again, this time excluding 0.9025, and you get the average of the other four.

MR. PELLY: I believe that's the case, yes.

MR. O'FLAHERTY: Okay, so I've ... and that would be the black dot which is shown in the interval six on our chart?

MR. PELLY: I think so, yes.

MR. O'FLAHERTY: Okay, so in each of the cases, the point that was being made by the Board's actuary was that the data points that you've excluded were the lowest or more than one of the lowest points that were within the five year data cohort, we'll call it. I know that's not the correct term, but would you agree with the statement by the Board's actuary?

MR. PELLY: Yes, I don't have any problem with the word "cohort", either.

MR. O'FLAHERTY: Okay, thanks, I'm getting the terminology. Now the red line that you arrive at here on your chart, I'm going to hop back over to your chart here, that red line is actually the line that flows through the points that's determined by the five year average, the four year average, the three year average, the four year average, the five year average, four year average progression that I just went through with the vertical, correct?

MR. PELLY: Reflects our selections, yes.

MR. O'FLAHERTY: Okay, now would you also agree that the red line for a just straight five year average would be a lower red line than this one you've come up with?

MR. PELLY: Yes.

MR. O'FLAHERTY: And would you also agree that the red line that would be developed by the Board through their, just consistent five year weighting average would be a lower red line?

MR. PELLY: Than the red one?

MR. O'FLAHERTY: Yes.

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, now I just want to look at the different numbers now, the differences from which the black dots move off, not the red line, but off the five year average number, okay? Now, what I'm going to ... this line is not on this particular chart, the five year average, but what I'm going to ask Mr. Pelly to assume is that if the line was the five year average, which is his default approach, how far would the data points be from the five year average in each case? Now, I'm going to suggest to you that, and I'll just do this by leading questions, okay, and then you can correct me if I'm incorrect ... the first interval of that analysis would not be relevant, would it, because there is no data point excluded.

MR. PELLY: They're the same value.

MR. O'FLAHERTY: Right, in the second interval, the point that you have selected would be point two, and I guess just to orient us, the five year average is going to be 1.1107, right, that's that second line in, as we're going to go across the page, which is in the second group of information.

MR. PELLY: Yeah, the third group of information, yes.

MR. O'FLAHERTY: I'm sorry, and the one I'm excluding, I'll just do this one, the one that you've excluded is .91, okay?

MR. PELLY: Yes.

MR. O'FLAHERTY: Alright, so the amount by which, and we'll call these points, okay, so this black dot is 20 points off the five year average there, would you agree?

MR. PELLY: Approximately.

MR. O'FLAHERTY: Okay, so that's 20, and if you go to the next interval, the two black dots in the number three interval are .05 and .07, so they're five and seven points off the five year average.

MR. PELLY: Approximately.

MR. O'FLAHERTY: Okay, and in the fourth interval the black dot is nine points off the five year average.

MR. PELLY: Approximately.

MR. O'FLAHERTY: Okay, and in the sixth interval, the black dot is again, nine points off the interval.

MR. PELLY: Approximately.

MR. O'FLAHERTY: I don't know if I skipped one.

MR. PELLY: I think you got them all.

MR. O'FLAHERTY: Okay, yes, alright, so ... and I just want to ask you, the blue dot, which is in the first group of information that you have there, and that would be the 1.4106, if we just go all the way back to the first column.

MR. PELLY: Yes.

MR. O'FLAHERTY: How far is that off the five year average ... well, I'm going to suggest to you it's 22 points off the five year average.

MR. PELLY: That sounds about right.

MR. O'FLAHERTY: Okay, so then we have a situation in which you're excluding points that are nine points off, nine points off, five and seven points, and 20 points off, but you have chosen not to exclude the point which is 22 ... which is the greatest, has the greatest difference from the five year average, the 22 points, would you agree with that?

MR. PELLY: I agree with that.

MR. O'FLAHERTY: Okay, now that's so ... would you agree that's further from the five year average than any other point, any other black dot that you have selected?

MR. PELLY: Selected to exclude.

MR. O'FLAHERTY: Selected to exclude.

MR. PELLY: That sounds like it's the case, yes.

MR. O'FLAHERTY: Now, of course, I take it that you wouldn't have any difficulty excluding points that were above the line, rather than below the line. This is, because, as you've indicated, this is not an exercise whereby you're just taking things off below the line.

MR. PELLY: Correct.

MR. O'FLAHERTY: Okay, now if, if we refer then to the page that I asked you to open, page 4.2 of the other, of the last filing, can you look at the first column there.

MR. PELLY: I have that.

MR. O'FLAHERTY: Now, in that first column, from the last, the last, you know, the vertical column that you made your selections from, we're still doing the same approach, you're going to make selections that are going to be based on excluding data points that are distortions, correct?

MR. PELLY: That's the objective.

MR. O'FLAHERTY: Okay, in this one, I would suggest to you that you have excluded the point which is 1.4652.

MR. PELLY: I believe that's the case.

MR. O'FLAHERTY: So you have selected one, in this case, which is 25 1/2, 26 points over the five year average.

MR. PELLY: Selected it to be excluded.

MR. O'FLAHERTY: Selected it to be excluded, sorry, I don't mean to be speeding up here, but ...

MR. PELLY: Okay.

MR. O'FLAHERTY: Okay, so that it is certainly open to you to take a point which is above the five year average like this, 25, 26 points higher, and you've done it in the past, and exclude it altogether.

MR. PELLY: Absolutely.

MR. O'FLAHERTY: Okay, and the reason for that would be because it represents a distortion in the data.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, now would you agree that the selection of your approach, well it's not even the selection of your approach, but that the effect of making these particular selections, if we go back to 2001, is to arrive at a significantly increased indication for private passenger rates ultimately. Now, that's not, actually that's not a very clear question, let me go back again. Would you agree that the selection of, or the removal of these selections in arriving at the selected loss development factor, will have the effect of arriving at higher indicated rates than if one were to adopt the Board actuary's or your general five year average approach.

MR. PELLY: In the current filing, that's true.

MR. O'FLAHERTY: Okay, now, can I bring you to the accident benefits in one of these charts, I just want to bring you to that one as well. That's page 4.1.6. Those are the loss triangles showed on the same schedule, we're still in private passenger vehicle but it's one of the other coverages.

MR. SAUNDERS, PRESIDING CHAIRMAN: What was the number again?

MR. O'FLAHERTY: 4.1.6.

MR. PELLY: 4.16, I guess.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MR. O'FLAHERTY: Okay, sorry, 4.16, yeah.

MR. PELLY: It's sort of an easier reference.

MR. O'FLAHERTY: Can you describe for the Board what the ... you know, what the approach is that's being used in this particular case?

MR. PELLY: Well, we would start with the same basic philosophy in approach so I wouldn't suggest that it's materially different.

MR. O'FLAHERTY: Well, maybe I can just highlight for you my point, it's a very straightforward point in any event. If you look at the average of the last five years, which is your default selection. In five out of the six vertical columns, you have selected values, which is the second, sorry, the second row from the last of the information proceeding horizontally, you selected values that are higher than the average of the last five years in five of the six vertical columns as we go out in time, is that correct? The only being 60 to 48 months ...

MR. PELLY: I think that's correct, yes.

MR. O'FLAHERTY: Okay, now, in order to arrive at that wouldn't you necessarily have to exclude again the lower, or lowest points that are within the data cohort in each of those five out of six cases?

MR. PELLY: I don't think that can be the general statement, but that may be the case.

MR. O'FLAHERTY: Yeah, okay, but you see, what I'm trying to say is that in order to ... if you have five years of data and you've arrived at an average that's higher than five years of data ...

MR. PELLY: You must have excluded some of the lower points.

MR. O'FLAHERTY: Okay, in each of the five out of six cases.

MR. PELLY: Yes.

MR. O'FLAHERTY: So again, you've judgementally excluded certain years with low values in order to arrive at the selected values.

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, now when I go back to this chart, Mr. Pelly, and I put this to you because this is what I'll be submitting to the Board, this is the cart at number 12, which is BGP-3 at page 12.

MR. PELLY: I have that.

MR. O'FLAHERTY: Okay, now if we can just look at the first interval there which has the blue dot which you've chosen not to exclude.

MR. PELLY: Yes.

MR. O'FLAHERTY: And that's the one that we've all ... that you and I have agreed is different from the five year average by more than any of the points that you have excluded.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, now when I look at this as a layman, you know, looking at trying to find where the points are on the chart, and we had sort of a back and forth on that yesterday, that seems to me to be the point that jumps off the page as being the point that's the most of a blip or an unexpected event, do you have any comment on that?

MR. PELLY: Oh, I'd be delighted to.

MR. O'FLAHERTY: Okay.

MR. PELLY: Probably two thoughts that come to mind. The first thought is that in the first column the development from 12 to 24 months in this particular coverage is the interval where you're going to have the biggest development because the claims are the most immature, or the least mature, so factors are naturally going to be more, there's going to be more randomness in the factors, or they'll be gravitating towards a higher value than would be the case in subsequent intervals, but the more important observations are all of the values that appear around the blue dot that we're talking about here that did not get excluded, the high value blue dot. You can see that it is not an outlier relative to the longer-term history. In fact, there's a lot of history in that vicinity. That's what distinguishes that blue dot from all of the excluded black dots which don't have a lot of supporting history context, historical comparative values. That's what led to the decision to not exclude that data point in this instance, but to make the exclusions in the other instances.

MR. O'FLAHERTY: Okay, when you were testifying yesterday, you agreed that the rates that had been proposed to the Board in 19 ... sorry, in 2001, were thought to be adequate at the time, is that correct?

MR. PELLY: I believe the indications were thought to be adequate, let's just take a look at them ... pretty close to adequacy.

MR. O'FLAHERTY: Okay, and you were, and you received an order from the Board which was very close to, or you know, quite close to what you had indicated were the required rates.

MR. PELLY: Well the deceptive thing there is what led to the Board's decision to move to a higher value in approval. The indications in the filing assumed a particular effective date, and that effective date was not realizable due to the timing of the final Board decision, so the Board when they were first trying to make a decision, we pointed out to them the time lag inherent in the approval process and I believe that may have influenced them to choose a higher approval level than they would have otherwise chosen prior to us bringing that point to their attention.

MR. O'FLAHERTY: Yes, I would concede that point, I think that's correct.

MR. PELLY: So as an indication in this application, that was predicated on a certain effective date which, I think it was about seven months, but I'm, that's a pretty distant memory right now ... which is about seven months short of what the indication needed to be given the actual timing of the implementation.

MR. O'FLAHERTY: Okay, maybe I'll come at the issue in just a little bit different way, okay, the ... from reading the narrative at page five, at the bottom it says that from these exhibits, and we're talking about the exhibits we've just looked at, we observe that the development assumptions for incurred losses at 31 December, 2001, are generally higher than those at 31 December 2000, due to the greater than expected emergence on older accident years during 2001, so I would suggest to you that the factor to which you have attributed the generally higher development assumptions for incurred losses is the unexpected emergence on older accident years in 2001, would you agree with that?

MR. PELLY: It has certainly been an influence, yes.

MR. O'FLAHERTY: Okay, so then something that was unexpected happened in 2001 that you didn't anticipate in your previous application, which has now caused this particular lift in rates, sorry, in loss development factors, would you agree with that?

MR. PELLY: The previous application was primarily based on older data than the one we're making reference to here, but in spirit, yes.

MR. O'FLAHERTY: Is that a fair point?

MR. PELLY: That's a fair point, I mean development was greater than expected.

MR. O'FLAHERTY: So then we're responding to something that's unexpected. Would you agree that your approach is more sensitive to the unexpected event than is the five year weighted approach which is suggested by the Board?

MR. PELLY: That would take some work to determine.

MR. O'FLAHERTY: Alright.

MR. PELLY: I don't think I can give you a quick answer to that.

MR. O'FLAHERTY: Okay, by excluding the lower points on a particular ... and you know, I might be coming at this in sort of a more layman's ... I'm sure I am, but by excluding the points that are lower from these four year, three year, and four year, and four year averages of the vertical columns, by that very process don't you make the analysis more sensitive to the unexpected event?

MR. PELLY: We're certainly choosing to respond to it, yes.

MR. O'FLAHERTY: Okay, and wouldn't you agree that the Board's approach, which is a ... the Board's actuary's approach, which is an across the board standard approach to each of the vertical columns would not respond as sensitively to the unexpected event because of it's very nature?

MR. PELLY: Once again, I'm not sure what you mean by the words standard approach, but it's certainly a normal mechanism ...

MR. O'FLAHERTY: And I don't mean to imply that your approach is not an appropriate approach. When I use the word "standard", I mean a consistent approach, and perhaps that's a much better way of putting it. The Board's actuaries are saying, use a consistent approach to each of these vertical columns, and your five year average default approach uses as consistent approach to each of these five years columns ... isn't it true that using either of those two approaches would not be as sensitive to the unexpected event?

MR. PELLY: In this instance, that's correct.

MR. O'FLAHERTY: Okay, and isn't it one of the general principles of actuarial science that you attempt to avoid an overreaction to an unexpected event?

MR. PELLY: Absolutely.

MR. O'FLAHERTY: Okay, I want to move on now to another statement about loss development factors, it's a separate topic within loss development factors. Can I ask you take out the Intervenor's prefiled evidence. There's evidence prefiled from a Mr. Winston Morris, which should be tabbed with his name on the ... it's alphabetical, so it would probably be about halfway down.

MR. PELLY: I have that.

MR. O'FLAHERTY: And open up at Tab 2, which should be the ... actually Tab 3, just go to Tab 3, and if you can just leave that open there for a sec, and I'm going to be referring to a statement that you've made in your narrative, and I'll just read it to you, I'm sure you're quite familiar with it. In general, that's at the bottom of page four, Facility Association loss development factors were selected on a basis consistent with the work carried out for the purpose of Facility Association's financial reporting.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay, now you will recall when you were qualified by Mr. Stamp, that I asked you the question whether, as part of your practice, were you also, did you also have expertise in the financial reporting aspect of actuarial science, do you recall that?

MR. PELLY: I do recall that.

MR. O'FLAHERTY: And you recall you agreed you do have such expertise?

MR. PELLY: I do.

MR. O'FLAHERTY: Okay, I want to ask you some questions about this particular area so I fully understand what's meant here.

MR. PELLY: Could I add a point of clarification?

MR. O'FLAHERTY: Sure.

MR. PELLY: Just as clarification, I do have general expertise in the area, but I want to make it clear that I am not the valuation actuary for Facility Association. I do function as their pricing actuary. The valuation actuary is a partner in my firm, and we work closely together to make the statement that's made in the filing a factual statement.

MR. O'FLAHERTY: No problem, I just wanted to point out, and I'm sure you're aware that in the website for your company, it does indicate that you are experienced in assisting clients to comply with financial reporting requirements.

MR. PELLY: And I'm not disagreeing with that.

MR. O'FLAHERTY: Okay, so we're on the same page then. Okay, in this particular document, the Intervenor's prefiled evidence, there is an indication in here that an actuary plays a role in the financial reporting with respect to the Facility Association's residual market segment, would you agree with that? I'll bring you to the, I'll bring you to the page, I think it's page 9 of 19.

MR. PELLY: Yes.

MR. O'FLAHERTY: And it also makes reference to ... sorry, it also makes reference to a note "AD" *(phonetic)*, as well, which is going to deal with incurred but not reported losses, and that type of information over at AD, so we're just looking at the role of the actuary, if you want to read that, you may be very familiar with the language.

MR. PELLY: I've perused it, if I need to get detail, I will get that.

MR. O'FLAHERTY: Okay, what is the role of an actuary in financial reporting for the Facility Association residual market segment?

MR. PELLY: In an effort to try and keep it simple, in effect, the actuary's role is to provide an opinion that the actuarial liabilities are fairly presented in the financial statements.

MR. O'FLAHERTY: Now, do ... and can we agree that the actuarial work which is being performed by, sorry, being performed on behalf of the Facility Association's residual market segment, is actuarial work performed by Eckler Partners Limited?

MR. PELLY: That's true.

MR. O'FLAHERTY: Okay, and it is performed, I'm assuming from what you've said, it's performed by a separate partner within the firm?

MR. PELLY: In conjunction with the assistance of staff, yes.

MR. O'FLAHERTY: Are you involved in that process?

MR. PELLY: I am consulted at stages, I'm not heavily involved in the valuation work.

MR. O'FLAHERTY: Okay, are actuaries, sorry, does Eckler Partners Limited specifically calculate or make ... calculate based on actuarial analysis of loss experience, the reserves for financial reporting purposes?

MR. PELLY: There's an unpaid claims liability that appears in the financial statements, portions of that are estimated by Eckler Partners.

MR. O'FLAHERTY: Does Eckler Partners select loss development factors for the purpose of arriving at these ultimate liabilities that are posted in the financial statements?

MR. PELLY: The process is similar to what we've been through.

MR. O'FLAHERTY: And the purpose of that is to provide an opinion to the regulators in particular jurisdictions that there are sufficient reserves to meet the liabilities of Facility.

MR. PELLY: In the specific case of Facility Association, it even goes beyond that. I mean, yes, it is to the regulators, but because of the sharing mechanism that Facility Association represents, having an actuary's opinion on the adequacy of the claims liabilities and premium liabilities for Facility Association is an efficiency to allow the appointed actuaries, or valuation actuaries of the member companies to rely on that opinion, rather than independently doing, each doing a valuation of Facility Association.

MR. O'FLAHERTY: And that makes perfect sense, I see where you're going and what you're saying. So in other words, so that the member companies don't have to post, or do opinions with respect to liabilities which could be a thousand companies, I guess, across Canada, you know, and I ...

MR. PELLY: Not that many, but ...

MR. O'FLAHERTY: Well, okay, 100, 100 companies across Canada, then Facility will facilitate that process and do it themselves.

MR. PELLY: And then that opinion is provided as a point of reference, and it's available for actuaries to rely on that opinion.

MR. O'FLAHERTY: Okay, so the actuary then plays a role both in estimating the loss development factors ... sorry, selecting the loss development factors for the purpose of financial reporting, and then for the purpose which we're here today for, of rate making.

MR. PELLY: Loss development plays a role in both.

MR. O'FLAHERTY: Okay, and do I understand ... now, I know that strictly speaking they're for two different purposes, I understand that, but I want to explore any overlaps between these two different practices that are being carried out here on behalf of, for Facility Association. In both cases, is the cost, sorry, the ultimate incurred cost of the same cohort of claims being estimated?

MR. PELLY: Well, for financial statement, for financial reporting purposes, it's all inclusive, it's all jurisdictions, it's all coverages, it's all classes of vehicles. For a rate application it's case specific, it's one jurisdiction, one class of vehicle, so I think my answer to your question is no because of that distinction.

MR. O'FLAHERTY: Okay, so you're indicating that ... okay, well within the, within the analysis of the incurred amounts ... alright, let me just stop for a sec ... so you're indicating that there is no analysis of the particular cohort of claims that you are analyzing for the purpose of rate making here in Newfoundland and Labrador, there's no separate analysis of that for financial reporting purposes?

MR. PELLY: That's correct, and they both draw from different data sources, there are different levels of detail, and the analyses are perhaps difficult to compare for that reason, and several other reasons, but nevertheless, the objective of analyzing loss development is similar.

MR. O'FLAHERTY: Okay, well what does your statement mean then, and perhaps I misunderstood, what does it mean that in general you select the loss development factors consistent with the work carried on for the purpose of Facility Association's financial reporting?

MR. PELLY: The consistency reference is primarily directed about the balance point between stability and responsiveness, so this is like, for example, the choice of using about a five year history as being a default, as you used as an expression earlier, and also whether we can look at it at the provincial level, or need to go to a broader geographical base and look at it at a regional level, those kinds of decisions are, we strive for consistency between pricing and valuation work. That's the consistency.

MR. O'FLAHERTY: But your evidence is that there is no comparison possible between the cohort of claims that the Board is looking at through your actuarial analysis, and the cohort of claims which is being reviewed for the purpose of reserves for financial reporting.

MR. PELLY: Well, let me give you a clarification of what I'm trying to convey.

MR. O'FLAHERTY: Okay, because I need that, thank you.

MR. PELLY: For purposes of financial statement reporting, you'll notice that Facility Association's fiscal year ends on October 31st, so when we're doing an analysis for financial reporting purposes, we are working with data, in actual fact, that's reported to

September 30th, and then we build in a projection to October 31st, and then verify close to the time when these statements are just being finalized, but we're working with an incomplete accident year, and we're working with data that is reported up to a point partway through a calendar period. That data is produced from an information system called the claims run-off system in ... or that's what I call it anyway ... within Facility Association, and it groups and organizes the data in a certain manner, an example of which is by coverage. It has data for liability, for accident benefits and for other. Those are the three coverage categories that are available from that system. When we're doing work for pricing, we're working with calendar accident year data, and either data reported to a December point or a June point. In this application it's a December point. The data is broken down at a much more refined level by coverage. We have bodily injury separate from property damage, we have uninsured auto on its own, and we have all of the physical damage coverages independently available to us. Two separate information sources, one much better suited to valuation work, one much better suited to pricing work, and we take advantage of each in the relative contexts.

MR. O'FLAHERTY: So then it isn't possible, your evidence is, to compare the loss development factors that you've used in the policy liabilities report for the purpose of financial reporting, with the loss development factors that are being used before the Board to justify particular rate revisions?

MR. PELLY: I would say it would be difficult for a layman to do it because there are a lot of things you need to think about when you are trying to draw that comparison. We provided your expert with an overview explanation of some of the differences that you need to consider, and we certainly made ourselves available to answer any follow questions that she may have had, and there haven't been any, so I'm, I don't want to say you can't draw a comparison because we do. In fact, we have a process that we go through and try and assess the consistency in the actual estimated ultimates between the two scenarios too, but you have to understand that you need to do an aggregation of the pricing work in order to draw a comparison with the valuation work in different ways because they're organized differently, so it's a non-trivial exercise to draw that comparison.

MR. O'FLAHERTY: Okay, I guess I'm asking you the follow-up questions, instead of the expert, about this particular topic, and perhaps I don't have the necessary level of indepth understanding of it right now, but what I do need to understand is there is a statement within, within the rate filing here that you make zero provision for profit, would you agree with that?

MR. PELLY: Yes.

MR. O'FLAHERTY: And is that a consistent practice right across Facility?

MR. PELLY: For pricing purposes, yes.

MR. O'FLAHERTY: For pricing purposes, okay, would it, would that then indicate that there's a need to have the same or very close loss development factors for pricing purposes as there are for reserve purposes?

MR. PELLY: If you're talking about the specific values, the answer, I can't make the answer yes, because you're working with two different kinds of data, but in terms of principle, in terms of what you're trying to accomplish with those loss development factors, I would agree.

MR. O'FLAHERTY: So you should have the same loss development factor for your reserve, and for your pricing purposes, if you don't want to make, if the aim is not to make a profit, but if the aim was to make a profit, you would expect to have higher loss development factors, sorry, yes, for rate making purposes, is that correct?

MR. PELLY: Well, you wouldn't accomplish it through the loss development factors, and even if, as I just said, even if, when you're trying to be the same, the factors themselves won't be the same because you're drawing from two different data sources.

MR. O'FLAHERTY: And as soon as I asked the question, I knew it was imprecise. Would the effect of having higher loss development factors for rate making purposes generally have the effect of generating an excess of premium over costs?

MR. PELLY: That's a potential consequence of it, but if you're seeking in a rate making context to build in a profit provision, you would not do it through loss development assumptions.

MR. O'FLAHERTY: No, I understand that, I followed your methodology, but would that be, would you agree that would be an effect of doing that?

MR. PELLY: In the event that you choose loss development assumptions that are, that prove to be whether by the unexpected happening, for example, if you choose loss development assumptions that have proved to be too conservative, then that can give rise to an excess of revenue over expenses.

MR. O'FLAHERTY: Okay, alright, Mr. Chairman, can I ask that we ... I'm going to head into another area, I know it's not right on the point when we'd have a break, but I'd just like to have a quick look at this material. It is a little bit thick and I'm going to head into the loss trends area.

MR. SAUNDERS, PRESIDING CHAIRMAN: So you want to break now is what you're saying?

MR. O'FLAHERTY: Well, if that's acceptable to the Board.

MR. SAUNDERS, PRESIDING CHAIRMAN: Sure, I don't think anyone would disagree with that, would they? Okay, well then is 15 minutes sufficient?

MR. O'FLAHERTY: That's fine, yes.

MR. SAUNDERS, PRESIDING CHAIRMAN: We'll try to be back at 25 past.

MR. O'FLAHERTY: Thank you.

(break)

(10:30 a.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, Mr. O'Flaherty.

MR. O'FLAHERTY: Thank you, Mr. Chairman. I'm going to head into the area of loss trending, but before I do I just want to touch on one other point so I'm perfectly clear on your answers regarding policy liabilities and the financial reporting aspect. In terms of the policy liabilities data analysis that's undertaken for the residual market segment of Facility Association, can you advise whether there are loss development factors specifically selected for Newfoundland policy liability?

MR. PELLY: Portions of the analysis use Newfoundland only data but the policy liabilities for Facility Association residual market are, for purposes of presentation in the financial statements, are aggregated, so I think my answer to your question is, yes, there is some analysis done at the jurisdictional level.

MR. O'FLAHERTY: Okay, there is.

MR. PELLY: Yes, but there is no, for purposes of expressing an opinion, the opinion is expressed for the Facility Association residual market as an entity.

MR. O'FLAHERTY: Okay.

MR. PELLY: Is that ...

MR. O'FLAHERTY: And I don't want to re-open the whole area or whatever, I just want to understand. So then it's a situation in which the seven jurisdictions, I believe you operate in seven jurisdictions?

MR. PELLY: Nine, I believe.

MR. O'FLAHERTY: Nine, I'm sorry, okay. And that the data of the nine jurisdictions is separately analyzed for policy liabilities by way of loss and then there is a selection for loss development factors made?

MR. PELLY: Portions of the analysis are at the jurisdictional level but it's not for every coverage, it's not in every instance that everything is carried through at the jurisdictional level. There are instances where we choose and find that it's more appropriate to use something at a regional level for basis, as a basis for making loss development assumptions. A good example is the very case that you took me to before on page 4.16. That is an example of a situation where we felt the need to go to our regional level and the 4.16 is showing Newfoundland data but we based our factor selections on Atlantic data and they were five year average factors based on Atlantic data and we present them on this page for purposes of the Board's review, but we disclosed, of course, in the narrative the fact that we used Atlantic data as the source.

MR. O'FLAHERTY: Yes, that's in the table. You show where you use different data.

MR. PELLY: Yes. So, I mean, and ...

MR. O'FLAHERTY: Page five, table here.

MR. PELLY: ... the use of jurisdictional versus regional data is one example of the consistency that we were striving for between financial reporting and pricing work.

MR. O'FLAHERTY: Okay. I may have a couple of other questions about that area but I just wanted to move on to loss trending now because I had promised to move to this area. Can I just ask, to orient ourselves in terms of the material, we're dealing with pages seven and eight of the narrative from the filing and Appendix A, Exhibit 5, and Appendix B, Exhibit 5 of the filing, and the previous trend selection from the 2001 filing are at Appendix A, Tab 5, for private passenger vehicle, and there is no prior exhibit for commercial vehicle coverage because there was no rate revision application in 2001 for commercial, correct?

MR. PELLY: Well, there is a prior one but it's not in the 2001 application.

MR. O'FLAHERTY: It's not in the 2001, yes, okay.

MR. SAUNDERS, PRESIDING CHAIRMAN: What were the appendices to the current filing that you were going to refer to, Mr. O'Flaherty?

MR. O'FLAHERTY: For Appendix A, Mr. Chairman, it would be Tab 5.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MR. O'FLAHERTY: And similarly ... and that would be for private passenger. Appendix B, Tab 5 is the commercial trending. There's a summary then followed by a series of exhibits, calculation exhibits.

MR. SAUNDERS, PRESIDING CHAIRMAN: I have it.

MR. O'FLAHERTY: Now, Mr. Pelly, when we're talking about loss trends, I take it we're applying an inflationary factor to the historical incurred cost to reflect forces outside the insurance industry. Is that correct?

MR. PELLY: I don't think I would agree that it's outside the insurance industry. The intent is to capture the forces like inflationary forces, but it's not just inflation, that act on the cost of claims, and that's typically in the insurance industry, to account for the expected movement through time.

MR. O'FLAHERTY: Your point is well taken. I guess what I'm trying to point out to the Board is we're taking into account issues that are generated outside of the claims continuum itself. These are matters that deal with the economy and deal with the environment that surround the people or act on the people that are insured through automobile insurance, would you agree with that?

MR. PELLY: Wherever those forces arise, yes, that's the intent.

MR. O'FLAHERTY: Okay. So this is a higher level analysis or it takes into account greater information than does, for example, the loss development factor analysis.

MR. PELLY: I struggle with agreeing with that. I mean, we're using claims experience in both environments.

MR. O'FLAHERTY: Okay, that's fine. Would you agree that there's a great deal of room for judgement in this particular area to establishing trends?

MR. PELLY: Judgement pervades actuarial work, but, yes, a great deal.

MR. O'FLAHERTY: Now, I take it that the choice of the data that you're going to use and the type of trending analysis you're going to use can be very significant in the trend that you arrive at.

MR. PELLY: I would agree.

MR. O'FLAHERTY: Is your analysis an unweighted regression analysis?

MR. PELLY: I think, if I am interpreting your expression correctly, I'll agree with that. If you're being technically sophisticated ...

MR. O'FLAHERTY: I'm not trying to be sophisticated.

MR. PELLY: A regression analysis that we're doing actually does involve weights but we're using a conventional log linear (phonetic) regression and in the sense that was raised by the Board's previous actuary it's not a weighted regression in that sense.

MR. O'FLAHERTY: Yeah. That's where I was going with that. Do you give equal weight to the recent experience and to the earlier experience in your trend analysis?

MR. PELLY: I have to say the same thing I just said but if you're referring to the weighting mechanism that the previous Board actuary's was, favoured, that is not what we're doing. We're using equal weights in that sense.

MR. O'FLAHERTY: Is this quite different than the approach which is being used by the Board's actuary in this particular case?

MR. PELLY: Our methodology?

MR. O'FLAHERTY: Yes.

MR. PELLY: No. I would say actually the regression technique that we're using is fairly similar to the regression technique used by the Board actuary. Where we differ is in decisions on how long of a historical period we would use or perhaps the inclusion or exclusion of data points.

MR. O'FLAHERTY: So the major differences are those outlined in the Mercer Report starting with the number of accident years that are going to be included. Can we agree with that?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay. Now you're using a long period of time for your ... that's a loaded question. You're using a longer period of time for your physical damage coverages as a general rule than the Board's actuary is recommending.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay. Now, do you use Facility data to develop your trends?

MR. PELLY: No, we use industry data.

MR. O'FLAHERTY: And the Board's actuaries are proposing the use of Atlantic data, I take it?

MR. PELLY: I believe with respect to private passenger vehicles they are in agreement to the use of provincial data. They are accepting of our use of provincial data for commercial vehicles but indicate that for certain coverages for purpose, for their purposes for developing the benchmark for the Board, I believe they used Atlantic data, so it's ...

MR. O'FLAHERTY: So they're using ...

MR. PELLY: They don't reject the use of provincial data in all cases by any means.

MR. O'FLAHERTY: Okay. As a general principle, is it necessary to make more judgmental exclusions with a smaller data set?

MR. PELLY: That's certainly a possibility.

MR. O'FLAHERTY: You showed us an exhibit yesterday, for example, with a big spike, I believe it was the commercial bodily injury trend, and where you showed where you had eliminated the spike.

MR. PELLY: Yes, and if you looked at Atlantic data over the same period of time, that spike probably would not look as pronounced.

MR. O'FLAHERTY: Right, okay. So that's the effect of using more data, is you, rather than smaller data when you're trending, you probably have to make more data exclusions for smaller data sets.

MR. PELLY: That's certainly a possibility. It might depend upon the critical mass of the smaller data set.

MR. O'FLAHERTY: Okay. Well let's just turn to the main issues now and we talked a lot about the section of half yearly versus yearly accident data yesterday. I'm going to go to, right to unemployment, okay? I ask you to look at BGP-3, page four. Now, I believe, if I'm not mistaken, that this was the set of data points that you indicated was a difficult set of data points through which to draw a line. Would you agree with that?

MR. PELLY: We found that to be the case, yes.

MR. O'FLAHERTY: And you're attempting to draw an exponential line through the data points, is that correct?

MR. PELLY: Technically it's a log linear line but, yes.

MR. O'FLAHERTY: Okay. What is the other possible way of drawing a line?

MR. PELLY: You can use regression to fit straight lines as well.

MR. O'FLAHERTY: Okay, alright. So, then this particular analysis then is broken down, because you say it's a difficult line, it's broken down into frequency and severity charts separately.

MR. PELLY: It's one of the techniques we've used and have applied in this instance.

MR. O'FLAHERTY: And that takes us to then the next two charts. The first one is severity, next one is frequency.

MR. PELLY: I have that.

MR. O'FLAHERTY: So because you found, if I'm correct now, and please correct me if I'm on the wrong track here, is because you found the initial data points to be difficult to plot that you broke it down into frequency and severity to look at it from that sort of a more in-depth analysis.

MR. PELLY: In point of fact the regression exhibits, the actual runs that we do, show information for an analysis of loss cost frequencies and severities all at the same time, so although we may have our focus on trying to fit to loss cost history, at the same time we have available a history for frequencies and severities and how the regression is performing in that regard as well, so we attempted some models to fit to the loss costs and we're not having success with that and looked to see if we could have success by separating it into its frequency and severity components.

MR. O'FLAHERTY: And that's the approach that you adopted?

MR. PELLY: Yes.

MR. O'FLAHERTY: And then that approach then was the means by which unemployment was added as a variable to No. 6, which would be the frequency trend.

MR. PELLY: That's correct.

MR. O'FLAHERTY: Now, would you agree that the consideration of the unemployment variable is significant to the annual claim frequency trend for property damage tort and collision, specifically that it appears to change the slope trend upwards?

MR. PELLY: The direction of the effect of the unemployment variable is, varies with the direction of the movement of the unemployment rate itself, so it's up in some instances and it's down in others, depending upon the point in time.

MR. O'FLAHERTY: Is the overall effect to change the slope upward?

MR. PELLY: Well, it depends on the time interval you're talking about, so I can't give you that simple an answer, but I would agree that it is significant.

MR. O'FLAHERTY: Would you agree that unemployment was not found to be a statistically significant variable in your last filing?

MR. PELLY: That's correct.

MR. O'FLAHERTY: And in the filing before that?

MR. PELLY: I don't have the information for the filing before that here with me, so ...

MR. O'FLAHERTY: Okay. Well, you can answer that later if you wish but ... now, if you had used the same time period in this filing as you did in the last filing, would the unemployment rate be a statistically significant variable?

MR. PELLY: That wouldn't be possible because in the current filing we're using data that was in the future at the time of the last filing.

MR. O'FLAHERTY: Okay. Can you just give me again the intuitive basis that you have for applying this variable to the frequency, property damage frequency coverages?

MR. PELLY: The intuitive argument that I most commonly understand relates to the manner in which the exposure arises initially, and I'll just use the expression, when times are tough, there may be less opportunity or intent to just go and drive somewhere for vacation, for pleasure, for non-essential things, and therefore there may be less exposure just generally on the roads. If there are fewer vehicles on the roads, then you're not likely to hit somebody else. That is the intuitive basis for the argument that economic cycle may have some bearing on claim frequencies.

(10:45 a.m.)

MR. O'FLAHERTY: Now, is the unemployment rate that's used in this particular analysis, we're dealing here with industry data, I take it?

MR. PELLY: For claims experience, yes.

MR. O'FLAHERTY: Yeah. Is the unemployment rate analyzed provincially or by territory?

MR. PELLY: We're using provincial data throughout the trend analysis.

MR. O'FLAHERTY: Okay. So the data is analyzed provincially and it's applied to the industry data. Is unemployment evenly distributed across the territories in Newfoundland and Labrador?

MR. PELLY: I would expect not.

MR. O'FLAHERTY: So would that have an effect on the manner in which your intuitive proposition would apply in this particular case?

MR. PELLY: It's arguable, yeah.

MR. O'FLAHERTY: Because it seems to me that there must be ... you know, I would put to you that the proposition that unemployment tends to be a very chronic problem outside of Territory 1, and that in the last few years it's, unemployment has lessened in Territory 1. Would you accept that?

MR. PELLY: Well, not being from this jurisdiction, it's a little harder for me to know those details but I'll accept it if that's ...

MR. O'FLAHERTY: Okay.

MR. PELLY: ... what your understanding is.

MR. O'FLAHERTY: Alright. We're going to ask you to assume that anyway, and that is a fair answer. You know, I don't expect you to have that information right at your fingertips, but if we assume that that's the case, that there's a disproportionate unemployment rate in one of the territories than to the other territories and your intuitive proposition is correct, wouldn't there have to be a massive increase proportionally in the number of property damage accidents in Territory 1?

MR. PELLY: I'm not sure how you came to that conclusion. Can you help me through that?

MR. O'FLAHERTY: Okay. The intuitive process is that the less unemployment, the more people drive their cars and the more accidents they have which involve property damage. Would you agree with that?

MR. PELLY: That was my intuitive basis.

MR. O'FLAHERTY: Okay. And then we're saying that if there's unemployment, then people will drive less and that will drive down the frequency.

MR. PELLY: Okay.

MR. O'FLAHERTY: If the ... in order for this to be applied across the board in Newfoundland, it's very difficult because we don't have a territorial analysis, do we?

MR. PELLY: Of trend?

MR. O'FLAHERTY: We don't break it down. We don't break down the unemployment by territory.

MR. PELLY: No.

MR. O'FLAHERTY: And there are areas of Newfoundland which have much more unemployment than others.

MR. PELLY: Yes.

MR. O'FLAHERTY: I'll leave the rest for argument as to how it works, but do you follow where I'm going with it?

MR. PELLY: I think I do.

MR. O'FLAHERTY: Okay. Would there need to be a higher rate of, a significant or proportionally higher rate of accidents in the areas in which unemployment has improved in order for your intuitive proposition to make sense here?

MR. PELLY: I can't leap to that conclusion and I'll try and explain why.

MR. O'FLAHERTY: Okay.

MR. PELLY: The trends are used in the analysis of provincial experience and, yes, that's a pooling process. We're dealing with the jurisdiction as a whole. When we come to drill down a little farther and try and develop indications at the territorial level, we are using territorial experience to guide us in that, and to the extent that that's been influenced by differences in unemployment rate at the territorial level, that will flow through into the actual claims dollars as well, so does it invalidate forecasting a provincial number and then distributing it by territory? I don't think so. I don't think it distorts the picture, but the territorial analysis, if the forecasting of an unemployment rate at the territorial level is radically different, then what happens at the provincial level? There's a risk that the territorial analysis that we do will lag that by whatever the duration of the trend is. There is a risk there. But the practicality would be that doing trend analysis at a territorial level is, well, it's challenging enough to do it at the provincial level, just because of sheer volume stability and the experience, so considering the possibility of doing it at a territorial level would be impractical.

MR. O'FLAHERTY: Okay. Doesn't the very, and accepting that my information is correct, that there's a significant deviation in unemployment between Territory 1 and the other territories, doesn't that add yet another variable to this particular, sorry, another consideration to the application of the unemployment variable in this particular case?

MR. PELLY: Well, again I think the territorial ... if the different unemployment rate in Territory 1 from the rural territories is a persistent pattern, then that will be evident in the historical data that we analyze at the territorial level, and provided that persistency remains going forward, then I believe the analysis captures that.

MR. O'FLAHERTY: Have you ... did you analyze that before I raise this issue with you?

MR. PELLY: I don't have any unemployment information at the territorial level but I haven't gone looking for it either.

MR. O'FLAHERTY: Okay. So then you hadn't previously thought to analyze this particular issue in terms of refining your trend analysis?

MR. PELLY: No, I haven't.

MR. O'FLAHERTY: Okay. And do you have any evidence that there is a, you know, a significant difference in frequency numbers between Territory 1 and the others on a per vehicle basis?

MR. PELLY: Sorry, would you repeat that for me?

MR. O'FLAHERTY: Okay. I'm going back to my proposition. Intuitively it seems to me that in order for your intuitive proposition to work, there would need to be many more accidents on the Avalon than there are in the other areas of Newfoundland because unemployment is much lower in this area of Newfoundland than it is in the other territories, okay. Do you have any evidence to that effect?

MR. PELLY: Well, we do do a territorial analysis and although it doesn't show claim frequencies I can take a quick look, if that helps.

MR. O'FLAHERTY: You don't have to answer that right now. We can come back to that, Mr. Pelly, you know, if it's going to take you a couple of minutes. I would be interested in the answer, but I'd rather a more precise answer than, you know ...

MR. PELLY: Well, I can give you a fairly quick answer.

MR. O'FLAHERTY: Okay.

MR. PELLY: Claim frequencies in Territory 1, which is basically the Avalon Peninsula ...

MR. O'FLAHERTY: Which document are you referring to, sir?

MR. PELLY: That's a good idea. I'm looking at page ... private passenger, page 3.2. Now, it takes a little bit of interpretation but probably the columns of most relevance to your question on claim frequency would be, there's a column sort of third in from the left that's labelled "Earned Exposures" in sort of a shorthand version, page 3.2.

MR. O'FLAHERTY: Yes.

MR. PELLY: It's capital "E," lower case, "r-n-d," and capital "E," "x-p-o-s." That's shorthand for earned exposures. And the other statistic you might look at is the right-hand most column that's labelled "Ultimate Counts," or "U-l-t C-n-t-s."

MR. O'FLAHERTY: Okay, thank you.

MR. PELLY: Claim frequency can be calculated or is calculated as the ratio of ultimate counts to earned exposures and just eyeballing what I see in the values here, you can see that the counts, the absolute value of the counts in Territory 1 are considerably higher than in Territory 2 at least, so that the claim frequency, just looking at the 2000 accident year or the two years that we've got combined even, just to look for persistency, that's a claim frequency of about ten percent, a little over ten percent for the two years combined in Territory 1, about five percent in Territory 2 and about seven percent in Territory 3.

MR. O'FLAHERTY: Okay.

MR. PELLY: That's for this particular coverage for private passenger vehicles for the two accident years combined and that coverage I was looking at was third party liability.

MR. O'FLAHERTY: Right, and we're talking about the third party liability for property damage which is a portion of that ...

MR. PELLY: Which is a piece of this.

MR. O'FLAHERTY: Right. So it's a little bit inexact. Okay. I just want to return then to the basic premise of how it came to be a statistically significant variable in this particular case as opposed to other years. Was there any change made in your methodology of approaching the question of trend from the previous analysis?

MR. PELLY: Not that I can identify, nothing evident.

MR. O'FLAHERTY: Can you explain to me then how it is that it became a statistically significant variable in this particular case using the same methodology but it was not in the last filing?

MR. PELLY: Well, I suppose the easiest explanation is that the addition of the more recent data that was available for two additional years of data and the behaviour of that data in conjunction with the unemployment rate allowed the regression to prove, that might be a little strong, to demonstrate that the unemployment variable was statistically significant. As I referenced yesterday, we do use tests to identify the statistical significance of a regressional variable to the overall regression, and although I can't recall all of the runs that we did for the previous application, I can be all but positive that we did test the statistical significance and if we found it wanting, then we would have rejected the model. We didn't find it wanting in the current application so we did not reject the model, we included unemployment, and the fact that it makes a contribution to the regression enhances the quality of the forecast.

MR. O'FLAHERTY: And actually my question was probably a little imprecise. I was more focusing on the methodology that you were using, whether there was any difference from the, you know, page 5.1 in the previous filing and 5.1 in this filing. For example, it's indicated, and as you've correctly pointed out, you can't use the same years because two more years have passed since then of accident year data, but there are years excluded from this particular, from the same particular data set that could have been excluded in 1999 but were not, would you agree?

MR. PELLY: That's true.

MR. O'FLAHERTY: So that is one change in methodology, at least used, that term used very loosely, methodology.

MR. PELLY: I would more typically categorize that as an assumption. The choice of the historical period and excluding data points, I agree, it's fuzzy, but I would be more characteristic of choosing that as an assumption rather than methodology.

MR. O'FLAHERTY: Alright. And does the choice of that as an assumption then have an effect on whether or not unemployment is a statistically significant variable this time around?

MR. PELLY: Well, I guess I would have to see a similar run done for the longer history from the previous application to confirm that, absolutely.

MR. O'FLAHERTY: Okay. Do you allow it's a possibility that that is the case?

MR. PELLY: It's quite possible.

MR. O'FLAHERTY: Okay. Would you agree that it is not a significant variable if the experience periods that are suggested by the Board's actuary are adopted?

MR. PELLY: I think I do have a regression run on that if you can give me a minute.

MR. O'FLAHERTY: Okay.

MR. PELLY: We're talking specifically the private passenger property damage frequency.

MR. O'FLAHERTY: Yes.

MR. PELLY: Is that correct? In the Board's actuary's recommendation ...

MR. O'FLAHERTY: I was focusing on their statement on page 16 that, "It is not a significant variable," this is in paragraph three from the bottom, third one up from the bottom, "It is not a significant variable if the experience periods we have suggested are considered." And you indicated you did a run on that basis?

MR. PELLY: I have it here. Just let me dig it out.

MR. SAUNDERS, PRESIDING CHAIRMAN: That's page 16 of the Mercer Report you're referring to?

MR. O'FLAHERTY: Page 16, yes, and it would be ... it's the third paragraph of the section which is headed, "Unemployment Rate."

MR. PELLY: Well, I find I misspoke because I only have a regression that basis excluding the unemployment variable, but I would point out that the regression excluding the unemployment variable is borderline meaningless. It has an R bar squared, well, has an R squared of eight percent, so the regress is not explaining, well, it's only explaining eight percent of the total variation of the claims experience, so it's ... whether the unemployment variable would be statistically significant in that regression or not is almost a moot point.

(11:00 a.m.)

MR. O'FLAHERTY: Okay. So you're not aware then of whether ... you can't answer the question of whether the Board's statement is correct or not?

MR. PELLY: No, I cannot.

MR. O'FLAHERTY: Can you answer the question of, this question, is the Board's statement correct that it is not a significant variable if a ten-year period is considered?

MR. PELLY: I don't think I have a run here to that effect.

MR. O'FLAHERTY: Okay. Now, I don't ... I just want to pass you a document here. This is the 2000, sorry, 1997 filing. You don't have to go look for that. Can you just briefly look at that and tell me if it was a specifically significant variable in the 1997 filing for property damage?

MR. PELLY: I can tell you that it wasn't adopted at the very least.

MR. O'FLAHERTY: I want to go on to the selection of flat frequency for the comprehensive coverage.

MR. PELLY: Yes.

MR. O'FLAHERTY: This is 5.31 and 5.32. I don't know if you have a coloured chart on this or not.

MR. PELLY: I think I did. Let me find that.

MR. O'FLAHERTY: I thought you did too, yeah. Maybe that will be more helpful.

MR. PELLY: Page 24 of BGP-3.

MR. SAUNDERS, PRESIDING CHAIRMAN: Three.

MR. O'FLAHERTY: Yes, thank you very much. Now, looking at the narrative of the document, it appears that the indicated frequency trend is minus 6.8 percent for comprehensive coverage frequency. Would you agree with that?

MR. PELLY: Yes, that's what got fitted.

MR. O'FLAHERTY: And this is a number that's arrived at on the basis of your actuarial analysis of a loss experience.

MR. PELLY: Yes.

MR. O'FLAHERTY: And you have selected a flat frequency trend of zero percent.

MR. PELLY: Going forward from 1999.

MR. O'FLAHERTY: And you have done so judgmentally.

MR. PELLY: I have.

MR. O'FLAHERTY: Would you agree that this type of selection increases the subjectivity of the analysis?

MR. PELLY: I would agree.

MR. O'FLAHERTY: Would you agree that this selection has the effect of increasing the steepness of the slope?

MR. PELLY: It changes it from a declining slope to a flat line, yes.

MR. O'FLAHERTY: That's more specific. Yeah, that's more precise, thank you. And would you agree that this selection has a significant effect on the ultimate 5.8 percent increasing trend that you've selected?

MR. PELLY: For loss cost combined.

MR. O'FLAHERTY: For loss cost combined, yes.

MR. PELLY: Yes.

MR. O'FLAHERTY: Now, I mentioned that I wouldn't be spending much time on the accident half year data. I just want to turn to the commercial vehicle BI coverage specifically.

MR. PELLY: For trend?

MR. O'FLAHERTY: Yes, I'm still on trend. And that would be Appendix B, Tab 5.

MR. PELLY: Perhaps page 5.4?

MR. O'FLAHERTY: Yes. 5.1 is a summary document ...

MR. PELLY: Yes.

MR. O'FLAHERTY: ... a narrative document, and 5.4 is the actual, the calculations. Thank you very much. Can you just remind me, what is the effect on a go forward basis of having 11.5 percent trend over the trend period? What type of an increase are we looking at overall, and I don't mean an increase in the amount of the premium, I mean what are we looking at in terms of predicting an increase from the date from which the trend began?

MR. PELLY: The duration of the trend?

MR. O'FLAHERTY: Yes.

MR. PELLY: For the latest accident year it's about two and a half years.

MR. O'FLAHERTY: Two and a half years. So ...

MR. PELLY: So you compound 11 1/2 percent per annum for a two and a half year period.

MR. O'FLAHERTY: So you're looking at a, approximately 25 percent? Oh, you have a calculator. Thank you very much.

MR. PELLY: I suppose I should be more precise on how long it is too. It's very close to two and a half years. About 31 percent.

MR. O'FLAHERTY: 31 percent is the ... what's the correct way of describing that? Is that the overall trend for the trend period or ...

MR. PELLY: Well, that's the contribution of the trend assumption alone, going forward from 2001 accident year to the projected average accident date for the rate program.

MR. O'FLAHERTY: And would you agree that that's a very significant trend figure?

MR. PELLY: It is.

MR. O'FLAHERTY: Would you agree that that's the highest trend figure that's shown in the filing?

MR. PELLY: I think that's probably true.

MR. O'FLAHERTY: Okay. And in terms of the ...

MR. PELLY: Yes.

MR. O'FLAHERTY: Sorry.

MR. PELLY: I can confirm that.

MR. O'FLAHERTY: And it is also higher than any of the trend figures shown in the previous filing based on the 1999 AIX?

MR. PELLY: Yes.

MR. O'FLAHERTY: And you have my previous filing there. Perhaps we can ...

MR. PELLY: So the answer is no in that instance.

MR. O'FLAHERTY: Okay. In that instance it's ... is that for commercial coverage there?

MR. PELLY: Yes.

MR. O'FLAHERTY: And what is it in that one?

MR. PELLY: 18 percent per annum.

MR. O'FLAHERTY: 18, okay. So it's the most significant figure that we're dealing with here today in any event.

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay. Now, what is the data set that's used to analyze the commercial vehicle for trending purposes for this particular coverage?

MR. PELLY: In the current application? As it states on page 5.1, we've used a historical period spanning 1990 to 2001 accident years and we analyze loss costs and it's provincial data.

MR. O'FLAHERTY: It's provincial data within Newfoundland and Labrador, okay. And that is by necessity a smaller data set than, for example ...

MR. PELLY: Excuse me, I misspoke.

MR. O'FLAHERTY: Okay.

MR. PELLY: I was looking at the private passenger exhibit.

MR. O'FLAHERTY: Okay.

MR. PELLY: I'm sorry. As it appears on page 5.1 in Appendix B, the rate application, we fitted the trend to an accident year history spanning the 1989 to 2001 accident years, with two data points excluded, the 1993, 1998 accident years, and again we were using provincial data for this coverage for loss costs. My apologies.

MR. O'FLAHERTY: No problem. It is still provincial data as well.

MR. PELLY: It is.

MR. O'FLAHERTY: And do I understand correctly that the Board's actuaries will propose using a larger data set?

MR. PELLY: I believe for this particular coverage they accepted and in fact endorsed the use of provincial data.

MR. O'FLAHERTY: Okay, (inaudible) check that. I don't think there's any ... I don't they take criticism with your use of the data in any of the cases they accepted.

MR. PELLY: My recollection is from their work on the benchmark.

MR. O'FLAHERTY: Yeah.

MR. PELLY: And I believe they used regional data, I'm sorry, provincial data for this coverage.

MR. O'FLAHERTY: Yeah. I think you're right. I think it's, and subject to correction, I think it's the, they're using the atlantic data from the, for the physical damage coverages.

MR. PELLY: That appears to be the case. I'm just checking the benchmark documentation on that. It's provincial data for bodily injury.

MR. O'FLAHERTY: Okay. That's helpful, thank you. Now, this is the area of trending in which the term outlier is used by, more specifically than in the loss development area, I take it, you're identifying outliers?

MR. PELLY: We identify outliers here too, yes.

MR. O'FLAHERTY: You're doing both, are you?

MR. PELLY: We call ... I think you adopted the term "distortion" and I accepted that but outlier is an acceptable term. They're not exactly the same thought process that goes into the two selections but conceptually you're trying to include data that is helping you build your expectation for the future.

MR. O'FLAHERTY: Okay. Now, I realize that you feel that the use of annual accident data, and you've testified to this yesterday, is the more appropriate methodology in this particular case.

MR. PELLY: I agree.

MR. O'FLAHERTY: Okay. And the Board actuaries take a different position. They believe that the use of half year accident data adds further precision to the analysis and allows you to take into account seasonality. Would you agree?

MR. PELLY: I would agree.

MR. O'FLAHERTY: And I take it your objection to seasonality is that it adds in a complexity to the trend analysis?

MR. PELLY: It adds one more feature that you need to deal with but the problem with the accident half year data in a jurisdiction that, if you accept that it has critical mass necessary to be reliable on an accident year basis when you break them down into accident half years, it's harder to have the same amount of faith, the same level of comfort with each accident half year point just by virtue of, call it the law of large numbers, if you want, but there just isn't going to be as much stability and therefore the trending process is harder to do.

MR. O'FLAHERTY: Okay. If you look at 5.4, which is the exhibit that you have brought me to, this is in Appendix B, 5.4.

MR. PELLY: I have that.

MR. O'FLAHERTY: What are we looking at here in terms of the projection factors and regression results, this data on top of the page, what are we looking at?

MR. PELLY: This is sort of the last phase of the regression and the top block of information presents the fitted, based on the regression model being selected here, the fitted loss costs for the latest five years and going forward, four additional years, as well as the estimate based on the expected future average accident date for the proposed rating period. There is also information presented, comparable information presented for severities and frequencies based on the same regression model, but in this instance, as the box is intended to convey below, our focus is on loss costs in this particular case.

MR. O'FLAHERTY: Okay. And why I was instantly drawn when I looked at this to the ultimate losses column, where I expect the members of Facility's were also drawn, these numbers 9,102,216 and 9,767,022 for the years 2000 and 2001, what do those numbers represent?

MR. PELLY: The estimate of the ultimate cost of claims for the industry for those two respective accident years.

MR. O'FLAHERTY: Okay. And how do those compare to the three previous accident years for this particular third party liability, bodily injury tort coverage?

MR. PELLY: All higher, both higher.

MR. O'FLAHERTY: Significantly higher?

MR. PELLY: Sure.

MR. O'FLAHERTY: Okay. And what about the number of accidents in those two years for this particular coverage then compared to the three previous years?

MR. PELLY: Both higher.

MR. O'FLAHERTY: Now, if you were to take that information and break it down half yearly as the Board's actuaries are suggesting, could you find out, sorry, is it possible to determine whether or not a disproportionate number of those accidents and loss costs were attributable to the winter period of 2000 and 2001?

MR. PELLY: Literally speaking, no, because the accident half year data is separated on the December/June line, and what you would need for your question was a separation on the sort of ... I don't know, when does winter start here?

MR. O'FLAHERTY: Let me ask the question a little bit differently. Would that enable you to add greater precision to determining the question of whether or not a disproportionate amount of those losses and accidents occurred within a particular period of time in 2000 and 2001?

MR. PELLY: It's not obvious to me how that could be the case, no.

MR. O'FLAHERTY: How you could do that?

MR. PELLY: No, to get greater precision than that, no, I don't see that.

MR. O'FLAHERTY: Okay, so you don't, so then the statement here, you don't agree with the statement that this is an example of the extra precision that can be obtained from consideration of accident half year data as compared to annual accident year data?

MR. PELLY: Well, I believe that statement either preceded or followed the inference that the extreme value, the cause and effect relationship for the extreme value was the winter storms, and I don't know how they came to that conclusion.

MR. O'FLAHERTY: I'm not asking you to accept that, I'm just ... that's why I went to the loss cost and the number of accidents. I'm certainly not suggesting you can draw the link from just looking at these numbers that these were as a result of ... and you call it the winter storm of 2000/2001 on a couple of ...

MR. PELLY: That's the way it's etched in my memory.

MR. O'FLAHERTY: ... occasions. I can tell you from personal experience, there was many more than one winter storm that winter, but in any event.

MR. PELLY: It seemed it occurred each time I visited, but you actually just raised an interesting point, Mr. O'Flaherty, you asked me to compare the losses, and because of the rising number of exposures, it's helpful to actually compare the loss costs and the frequencies, because that way it gets expressed on a unitized basis, and the previous page, page 5.3, while the same pattern exists that the column labelled ULTLC for ultimate loss cost, the last two data points are indeed higher than the preceding three, but by virtue of these being unitized, expressed on a per vehicle basis, the observation that you were conveying earlier is dampened because the number of vehicles is an increasing statistic as you go through time.

MR. O'FLAHERTY: Yes, it is, you're correct, but once again, it's not, it's not possible to just look at the raw numbers and draw the link to the winter, and we agree on that, okay. What I'm wondering about is the point about the added precision of looking at half year data, just to ... in this particular case, would you agree that that would certainly add some degree of precision greater than looking at just the year data for this particular period of time and this coverage?

MR. PELLY: I can't see that from looking at the exhibits that were prepared by the Board's actuary for purposes of presenting their view of the trends, so I can't see the same thing, no.

MR. O'FLAHERTY: That's fine, if, if the data from, if the Board's actuary is correct and the data from that particular period was excluded as an outlier, would it have the effect of having a lower loss cost trend for this particular coverage in commercial vehicles?

MR. PELLY: Yes.

MR. O'FLAHERTY: And would that have the effect of lowering the indicated rate level change for that coverage?

MR. PELLY: Yes.

MR. O'FLAHERTY: Do you have a ... well, you can't comment on the amount, I'd have to ask her about that?

MR. PELLY: I don't have that regression done here.

MR. O'FLAHERTY: Okay, but we do agree on some things, that this is a very significant increase in the trend, the 11.5 percent figure, and over the trend period it's 31 percent, is that what you said?

MR. PELLY: As a contribution to the forecast, I mean it's difficult to say how much this one assumption contributes to the overall because it's one of a number of assumptions. It's a, you know, which one comes first question.

MR. O'FLAHERTY: Right.

MR. PELLY: But in the analysis of the 2000 AIX, our estimate of the annual trend was 9.6 percent, and in this analysis it's 11.5, that's almost a two percentage point increase in a per annum assumption, and that's a fairly significant shift.

MR. O'FLAHERTY: I'm almost finished with this area now. I just want to talk about the difference between your approach to the last section which we were involved in, which is the loss development factors, and explore how you're approaching the issue of loss trend and see if there's any, if we can find any common ground there. I think my proposition to you was that your selection and exclusion of certain years in the selection of loss development factors made your analysis more sensitive to the recent loss experience, would you agree with that?

MR. PELLY: In those instances where we felt that was a necessary step to take to build an assumption that was reasonable for future, in a future context, I would agree, we found it necessary to be more responsive to the latest experience.

MR. O'FLAHERTY: Now, your approach to the loss trends appears to be to look at a longer period of time, quite a significant period of time in some cases, and I'm just ... I suggest 18 years, for example, would be one, in order to avoid, I take it, responsiveness to the latest experience.

MR. PELLY: Well, this trending and loss development are different processes and ...

MR. O'FLAHERTY: I understand that, and that's what I'm asking you, if you can reconcile for me why I seem to be hearing one message with respect to loss development factors, and yet there's a different message emerging from your analysis of the loss trend.

MR. PELLY: And I hear what you're saying. This all stems from the need to, the fundamentals of rate making, the need to build an expectation for a future rating period. Trend, underlying trend, not the noise that can exist in a year, or one or two years of claims data, but the underlying trend that is causing movement in claims cost, or unit claims cost from year to year, is a long-term phenomena. It can change through time, I acknowledge that, but in order to be able to measure it with some level of confidence, you run the risk of being too responsive if you use short periods of history. An example would be the use of five years of data. If you take a philosophical stance that that's the level of responsiveness, because that's what I, basically what I did in loss development, I wanted to use five years of data. If you do the same thing in trending, and choose to use your trending analysis on five years of date, the consequence of going from one year's analysis to the next year's analysis can mean a very, very significant shift in the resulting trend assumption, and all that tells me is that you're not doing a very good job, because even doing what I've been doing, I get significant shifts in my forecasts, and I'm taking a very stable approach to doing regression analysis.

If you use a five year basis for establishing an expectation for trend, you run the risk of having forecasts that will swing from very, very significant increases to very, very significant decreases, and then back to increases again the next year, all because you have, you're dropping one of your earlier data points, and you're picking up a new one, and suddenly the appearance of those five data points changes from being upward sloping to downward sloping.

That just isn't good practice. You need to try and squeeze out of the data what the underlying forces are and give recognition to them in your forecast.

MR. O'FLAHERTY: So I take it that your approach here is to avoid a knee-jerk reaction to, as you said, one of the dips or lifts in the, in the data that you're seeing presented for the purpose of your trend analysis?

MR. PELLY: To take the ... yes, but to take the ultimate in responsiveness, I could have taken the ratio of the 2001 loss cost to the 2000 lost cost, and said that's my annual trend, and if that happens to go up, then my future expectation is that it's going to continue to go up, and if a year later it happens to go down, then the logic would say that my future expectation is that it's going to go down. The reality is there's noise in this data. It's, it's never turns out exactly as expected. It always, it's the outcome of thousands of events. Some of them are very significant and can cause distortions in the data, or sometimes there's the absence of anything significant, and that's almost a distortion in the data because there's an expectation of some level of significant claims.

The reality is that you need to smooth out the bumps, you need to be prudent in terms of avoiding overreacting to what is an emerging issue in the data. That's why we take a longer-term view for selection of a trend period history.

MR. O'FLAHERTY: Than would the Board's actuary recommend?

MR. PELLY: At least with respect to the physical damage coverages, that's their position.

MR. O'FLAHERTY: Now, how do you reconcile that, or perhaps, let me ask you a specific question, is that consistent with your view with respect to the comprehensive coverage where you've decided that from 1999, a relatively recent period forward, that you would project a zero percent flat frequency. Doesn't that seem to contradict your overall view of a trend analysis?

MR. PELLY: Well, I don't think so obviously.

MR. O'FLAHERTY: Perhaps you could explain that to me.

MR. PELLY: I can try again, and I might refer the panel and other interested parties to page 32 of BGP-3 for the pictorial representation. I've taken a longer term view in terms of giving recognition, trying to eke out how claim frequencies for this particular coverage have moved through time, and the answer seems to be that over the history that I've used, claim frequencies have been in a declining state, but I can't move away from the fact that when I look at the last six data points, six years of data, they are not fundamentally following the same general pattern as exhibited by the previous nine years. You can see that there's a, there seems to have been a shift, and maybe not unlike the shift that occurred back in 1989.

It is very difficult for actuaries to know when they should believe what they're seeing a trend sense. It's not an easy process to know when you should drop off the older history and start relying solely on the newer history. It may be, with the 2002 AIX that I do that, I don't know that yet, I'm not going to know that until I do the analysis, but I'm going to have to have a strong level of comfort that regression based on data, say only since 1996, if I want to accept that as a turning point, I'm going to have to have a strong impression that that's, that is the trend. I've got to have confidence in that in order to be able to put my name to it.

What I do have confidence in is I cannot fathom continuing a projection of declining frequencies beyond historical levels that have ever been accomplished in this history when I can see that there is a general flatness to the recent history. Those two just don't jive, and so I take a, a slightly, well significant in terms of its impact, but a moderate position, rather than forecasting increasing frequencies based on a five or six year history here, I'm moderating that and choosing to just say, I'm not going to say they're going to go up, I'm going to say they're not going to go down any more, so I'm going to go ahead on a flat even keel. That's the basis for the logic.

MR. O'FLAHERTY: So it's a question, it's a question of the confidence that you have that this particular, this particular presentation will continue in the manner ... and you don't feel that that confidence is warranted for the declining trend, and you're prepared to select it as of 1999 as flat frequency, based on your level of confidence.

MR. PELLY: Just a visual inspection of the, of the short history that's available since 1996, it looks like a fitted frequency trend there would be increasing, and I'm not prepared to stick my neck out that far yet. I'm not sure that it's an increasing trend yet. It could just be random noise with a walk *(phonetic)*, and ... up and down, and there are instances, although I can't think of one in this particular filing, there are instances where that's evident throughout the history of claims frequencies, where it's just a random walk, it seems to be just an up/down, down two years in a row, up a couple of years, there's really no pattern to it. We fit 30 different regressions to it and can't find one that's giving us anything meaningful. What do we conclude under those circumstances? It's not forecastable, that's what we conclude, and we build in basically no trend expectation. It won't be exactly on a zero percent level, but it's not forecastable, it's not something that's lending itself to a pattern of change through time.

MR. O'FLAHERTY: Okay, so you're recommending then that the Board avoid responsiveness with respect to trends, generally, as a philosophical approach, would you agree with that?

MR. PELLY: No, I wouldn't agree with that, because we pull in the latest data, we're trying to give recognition to the patterns, and they get influenced really quite significantly by the latest data points.

MR. O'FLAHERTY: Okay, no problem, I'll rephrase the question then. Would you agree then that you are cautioning against overreacting to the latest data?

MR. PELLY: Absolutely.

MR. O'FLAHERTY: Okay, in terms of the trend, and that ... now, if we go back to the loss development factors, you don't, you seem to have a greater degree of confidence in the latest information for the purposes of projecting the accident and experience.

MR. PELLY: Well, there's an additional consideration in the selection of loss development assumptions. We were looking at Facility Association only data. We also have a body of data available to us that's industry data, much like we have here, and one of the facts that the insurance industry is facing in Newfoundland and Labrador and other Atlantic jurisdictions, and frankly in many jurisdictions across this country, it's becoming a harsher claims environment. There is more aggressive loss development evident in the last two or three calendar years of time than has been evident in the earlier periods, particularly on coverages like bodily injury and accident benefits. The result is that that calls, in order to build a reasonable expectation for the future that calls in loss development selection for more responsiveness. You need to recognize that at some level in order to be able to be confident or have a comfort level with your assumption going forward. So sure, we have some knowledge of what's going on at an industry level, and that does influence our selection mindset at the Facility Association level.

MR. O'FLAHERTY: Now, I'm going to just ask you a couple of questions about the unallocated loss adjustment expense provision.

MR. PELLY: Yes.

MR. O'FLAHERTY: Now, the ULAE factor, this is found at ... I'm sorry, Mr. Chairman, I'll just orient you ... it's at page 18, thank you.

MR. SAUNDERS, PRESIDING CHAIRMAN: On the Eckler report, the filing?

MR. O'FLAHERTY: Yes, on the filing ... no, not 18, it's page 9.

MR. PELLY: I'm sorry, I thought you were referring to the Mercer section, I'm sorry.

MR. O'FLAHERTY: Yes, the top of page 9, unallocated loss adjustment expenses.

MR. PELLY: Yes, I have that.

MR. O'FLAHERTY: Now this is an issue upon which you took significant umbrage yesterday with respect to the Board's actuary, if I recall.

MR. PELLY: Yeah, that sounds like a good description.

MR. O'FLAHERTY: Okay, now would you agree that the ULAE factor used in the filing is the IBC estimate of the industry ratio of ULAE to losses and allocated loss adjustment expenses?

MR. PELLY: Yes.

MR. O'FLAHERTY: And that figure is 1.093?

MR. PELLY: For the 2001 accident year.

MR. O'FLAHERTY: And was this the ... I'm sorry, was this the approach that was used in the prior filing?

MR. PELLY: Yes.

MR. O'FLAHERTY: And the one before that?

MR. PELLY: To the best of my recollection?

MR. O'FLAHERTY: Okay, and has the IBC released an updated estimate of the industry ratio of ULAE to losses and ALAE?

MR. PELLY: For the 2001 accident year?

MR. O'FLAHERTY: Yes.

MR. PELLY: That was the information provided by the Board actuary. I'm not aware of it being in a public domain document, but it perhaps is.

MR. O'FLAHERTY: And that's the 1.082 figure that was provided by the Board's actuary?

MR. PELLY: Yes.

MR. O'FLAHERTY: And do you accept that it's reasonable to use updated information where it's available?

MR. PELLY: Yes.

MR. O'FLAHERTY: And if it had been available, do I take it then that you would have used that information for your report?

MR. PELLY: At the time when we did the work, yes.

MR. O'FLAHERTY: Okay, so then the difficulty is more in the phraseology of the way that the Board's actuaries addressed it, rather than their conclusion that it's appropriate to use 1.082.

MR. PELLY: No, I disagree. The recommendation being made by the Board's actuary is that we should have used 1.082. The work was done in June, the factor didn't become available until after that time, so their recommendation is that we should have gone back and redone the work in order to incorporate an updated statistic.

MR. O'FLAHERTY: Sure, and I don't mean to misinterpret what you're saying. My point is simply that this is the same information but a more updated version of it, is that correct?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, and if that information was available you would have used it, is that fair to say?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, we'll pass on then. I want to go then to the issue of the credibility. Now in terms of ... just tell us a little bit about the use of credibility and why it is that you want to make the, you're testing the data against industry data, can you explain that a little bit?

MR. PELLY: The concept of credibility is to provide an objective measure of the level of confidence to be attached to a particular statistic. It has its foundation in a lot of theory and to be honest not all of the conditions of the theory always hold, but the value in using a credibility technique is the objectivity that it brings to the measurement process, how much faith, how much comfort should I have with a particular body of data or with a particular statistic. It's used in the context of our rate making to allow us to give recognition to a body of data that perhaps isn't fully reliable, but is partially reliable, and to give recognition to that in a tempered way and balancing that with weighted recognition of some other body of data, for example, Facility Association data and industry data, or ... well actually, I think that's probably the best example that we have in the application, so it's an objective measure of ... I'll use the word "reliability". It is, the standard for full credibility varies by coverage, and we have chosen a basis for using the number of claims as the means of measuring the, assessing the credibility.

MR. O'FLAHERTY: Now, in determining the rate level needs for third party liability, you have chosen to combine the experience for bodily injury and property damage, for credibility purposes, rather than analyze them separately. Can you explain why you chose that measure, or that approach?

MR. PELLY: That is the approach that we've been using for some time in jurisdictions outside of Ontario, and in part, I guess the answer is I am, my starting point for a new year's analysis is always where I left things off the year before. I acknowledged in my evidence yesterday that the suggestion merits further consideration and I intend to that. Frankly, it's not something that I gave much thought to previously, but I'm open to the idea of exploring its possibility, its application. I would caution that the approach for the restatement purposes that the Board actuary undertook, they did do some analysis of the potential impact of doing this, and necessarily they were limited in what they could do because they don't have access to a long history either by virtue of their role in this process. One would need to spend a little bit of time building up some of the values that are used for the balance of credibility when you are splitting the two.

Property damage, based on their recommendation, becomes fully credible, so it's not too much of an issue there, but for bodily injury, that coverage isn't fully credible by current measures. We would have to revisit the full credibility standard that we would use for that coverage, and we would need to reassess what we should use for the balance of credibility for purposes of calculating things that we call, like the risk factor, which is a loading that's applied to industry data to recognize the extra inherent riskiness of Facility Association experience.

I'm not sure what the Board actuary did for that purpose, but those things would require very, very careful scrutiny and study to build up a reasonable foundation to use as a starting point to go into a new approach. I'm sure she hasn't had the opportunity to do all of that. I would want to do that but I think it's a reasonable suggestion?

MR. O'FLAHERTY: Does it seem to you to be intuitively correct to accept the point of the Board's actuary that were you to add this extra level of analysis and precision that it would have a downward effect on the indicated rate level changes?

MR. PELLY: I don't know.

MR. O'FLAHERTY: Okay.

MR. PELLY: That's one of the reasons why I gave you the lengthy answer I just did. That's, I think that was the outcome of what her analysis did, and I don't fault the analysis but she doesn't have all of the information necessary in order to construct that context for making the change, so I would want to do that study.

MR. O'FLAHERTY: And that's why I asked you the question, does it seem intuitively to be, to make sense that it would lower the indicated rate level needs rather than to ask you ...

MR. PELLY: I guess my answer would be I don't have an intuitive expectation, and I would have to build one from actually going through the exercise.

MR. O'FLAHERTY: That's fine.

MR. PELLY: But I should point out that the separation of bodily injury and property damage is done substantially through out analysis. That is a cornerstone of our work in the sense that we recognize the value of separating the two coverages, and giving recognition to the different characteristics of those two coverages. That was a point of issue in our work between us and the previous Board actuary, they disagreed with us about that, and they preferred that it be analyzed on a combined basis. We were adamant that we wanted to continue the analysis on a split basis, so I'm pleased that the current Board actuary supports that position and I appreciate the thought that there's an opportunity to take it a little bit farther in our analysis, and if that improves the process, then I'm pleased to pursue that.

MR. O'FLAHERTY: Yes, you're referring to the benchmark methodology, are you ...

MR. PELLY: The previous ...

MR. O'FLAHERTY: The previous ...

MR. PELLY: ... Board actuary's benchmark methodology.

MR. O'FLAHERTY: Okay, can we just pass on to one other topic, perhaps, and again, this is a fairly technical topic. This is the issue of the calculation of the risk factor. Mr. Chairman, I can go into that now if you like. It is, it's fairly complex, or we can take a break now. I'm prepared to go either way.

MR. SAUNDERS, PRESIDING CHAIRMAN: Well, how does the witness feel? Would you like to take a break now or ...

MR. PELLY: No, I'm happy to plough on, sir.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, well let's plough on until 12:00 noon.

MR. O'FLAHERTY: Okay, sir. Now, you had indicated that a related topic is the calculation of the risk factor, so would I be correct in saying that the risk factor is used because it's necessary to adjust the industry data to make it more like Facility data in this case?

MR. PELLY: For purposes of using it as a reference point for balance of credibility calculations, yes.

MR. O'FLAHERTY: Okay, and this is a, you do this by making multiplicative adjustments now to the industry data, is that how you're going to do this?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, and this is quite a, quite an indepth, I guess it's not an algorithm, but what would you call that, a calculation of some sort, is it?

MR. PELLY: Sure.

MR. O'FLAHERTY: Okay, so it's at page 7.1, and ... sorry, 7.2 of your exhibit, appendix ...

MR. PELLY: That's the case ...

MR. O'FLAHERTY: Sorry.

MR. PELLY: That's the case for third party liability.

MR. O'FLAHERTY: For third party liability, just go to that one, 7.2 for ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Appendix?

MR. O'FLAHERTY: Appendix A, sorry, Mr. Chairman, yeah. So the calculation that I was referring to is on the bottom of the page, and that's risk factor is credibility weighted average of average FA over industry ratio and current risk factor?

MR. PELLY: I'm sure that makes a lot of sense, yes.

MR. O'FLAHERTY: I know, and that's why I'm saying I know it's a very thick area and this may not be something that, you know, I can shed a lot of light on here, but I think it's an important point and I want to ask you about it because it's part of my job to follow up on these particular points. It seems like there are two different multiplicative adjustments that are being made to the industry data here. Can I ask you, this vertical column labelled DISTN, what does that particular column refer to?

MR. PELLY: That is another multiplicative factor. It is an adjustment that's made only to the industry data and it's an estimate of restating the industry loss cost to reflect what it would be if it had the same distribution of business as Facility Association did by class, or driving record, or limit, or deductible, or rate group, or territory ... excuse me, not rate group because we don't have that data ... exclude rate group from that list.

MR. O'FLAHERTY: Okay.

MR. PELLY: But all the other ones are adjusted for.

MR. O'FLAHERTY: Okay, now you also have a risk factor, and the value for that is shown as one point ... sorry, this is two columns further to the right, which is another vertical column, this is risk factor, what is this one?

MR. PELLY: This factor is intended to capture the extra inherent riskiness of Facility Association business compared to typical industry business even after allowing for or recognizing the distributional difference between the two bodies of data.

MR. O'FLAHERTY: That's where I was going with this because they seem to me to be already captured, one within the other, and ...

MR. PELLY: Well, to some extent, I mean the distributional difference, if you're looking at an overall average loss cost of claims per vehicle for industry and for Facility Association and comparing those two, part of the reason why they're different is because some of the risks that are in Facility Association are there because they're, because of their accident and conviction record, they have a propensity for getting into accidents, and inherently they're going to be in lower driving records as a result of that ... lower driving records generally have poorer, or higher loss costs, so part of the reason for why Facility Association loss costs and industry loss costs are different is because they're focus, the concentration of the business is focused in a different area. But even after you account for that, there is something special about risks that are in Facility Association when taken as a group. They are riskier, they exhibit higher costs of claims going beyond anything that we're capturing in the classification plan. There is something inherently greater about the expected cost of claims, or even the historical actual cost of claims in a Facility Association book of business compared to the industry. That's what we're trying to measure here, because we need to be able to use industry experience to build up enough credibility in our forecasts for the expected loss cost, and in order to use industry data we need to recognize that extra inherent riskiness in Facility Association experience.

MR. O'FLAHERTY: Okay, now I'm not going to ask you to turn to this but at page nine you make this statement ... Facility Association experience generally has significantly higher loss costs than the industry even after allowing for distributional differences. That's the reference in the narrative, correct?

MR. PELLY: Yes.

MR. O'FLAHERTY: Now, is this a, is this an analysis that you've, or this calculation that is reflected here with these two multiplicative factors in there, is this something which is used on an industry-wide basis, or is this something that's Eckler Partners Limited's approach to this?

MR. PELLY: There only is one Facility Association in Canada.

MR. O'FLAHERTY: Fair enough.

MR. PELLY: And we're fortunate enough to be able to do work for them. This methodology has evolved and has been this way for several years as a basic approach to dealing with this. On several occasions we have explored developing alternative approaches because, as with any approach, there are some inherent weaknesses in any approach, and this has its share.

We have examined a number of different approaches to try and deal with how else to build up something as a basis for the balance of credibility in this calculation. Our efforts to date in that regard have not resulted in anything that represents an improvement.

This has built in process to try and avoid significant swings resulting from this and that's important in a rate making context. There are alternatives and different actuaries have different views, but this methodology has been discussed in some detail, and this is a central, this is a really key element of the Facility Association methodology, and I don't want to diminish it.

MR. O'FLAHERTY: No, no, I agree.

MR. PELLY: This has been reviewed by a lot of different actuaries over the years and although they may start with a point of view that there's a problem, I have yet to end up in a situation where they don't agree that it's a reasonable approach at the end of the discussion, whether it be in a public hearing or a table at a meeting discussing the filing or whatever the context might be.

MR. O'FLAHERTY: So then you have been made aware before of the possibility that these two multiplicative factors are, have an element of duplication to them?

MR. PELLY: Not these two factors, no, but there is a circular, it's difficult perhaps for laypeople to pick up, but there is a circularity that's inherent to this process and that's one of the weaknesses potentially, but the fortunate thing is that the, in the situation where Facility Association's experience is the most credible, that's when the circularity is the most prevalent, and also as a consequence of Facility Association's high credibility, it's of the least consequence. The converse is also true, the circularity is the least, is at its minimum impact in situations where it's needed the most, the industry data, so it's a convenient outcome of the way the methodology was devised, not coincidentally, but it does have its blemishes, as do all methodologies.

MR. O'FLAHERTY: Would you agree that ... okay, and perhaps, Mr. Chairman, I hope I'm not getting too far afield on this, I just want to ask a couple of more questions about this. Would you agree if you backed out the distribution factor from the risk factor, and if you accept my premise that it is already to a certain extent, you know, included in the risk factor, wouldn't that have the effect of lowering then the risk factor which would be applied multiplicatively in this instance?

MR. PELLY: Actually, no. If you didn't have the distributional adjustment, the column on page 7.2 of Appendix A, that's labelled the ULTLC, for ultimate loss cost, those would all be lower values. Do you accept that? I guess I'm not allowed to ask you questions. Sorry.

MR. O'FLAHERTY: Perhaps I didn't ask the question precisely. I wasn't thinking of ... I was thinking of leaving the distribution number in there, but making the risk factor lower by the amount by which it already is inherently reflecting the distribution factor, do you see where I'm ... that's what I'm saying, if I was unclear.

MR. PELLY: Let's explore where the risk factor comes from and that is the purpose of the footnote at the bottom of the page. The risk factor is derived from the footnote. The origin of the footnote is taking, it picks up the value at the foot of the column under the Facility Association block of information at the top of the page that's headed FA/IND, which is intended to convey the idea that it's Facility Association divided by industry.

MR. O'FLAHERTY: Is that the 1.8054 at the bottom?

MR. PELLY: That's the 1.8054, and that's just a straight average of the numbers that appear above it.

MR. O'FLAHERTY: Okay.

MR. PELLY: The numbers that appear above it are the ratio of the Facility Association ultimate loss cost to the adjusted industry ultimate loss cost, adjusted for the distributional differences, so the 1.8054 has, is the result of taking a ratio of loss costs that does not, that has already accounted for the distributional difference, so I mean there can be no redundancy there unless the measurement process is imperfect, and you know, it's not perfect, but ...

MR. O'FLAHERTY: Okay.

MR. PELLY: So the 1.8054 is a byproduct of having already removed the distributional, at least as an estimate, and the 1.8054 feeds into the formula at the bottom of the page. It's, a credibility is assigned to it, the balance of credibility is assigned to the previous year's analysis of the comparable statistic, and the result is a credibility weighted average which is then subjected to a cap.

MR. O'FLAHERTY: Mr. Chairman, I know it's still five minutes to the break time, I'm wondering if I might ask that we break a couple of minutes early because that way I might be able to shorten things by organizing a couple of pointed questions on this rather than ... I think I'm starting to, you know, sort of get a little bit far afield on this, and I want to just make a couple of points on it and I think that would be a quicker way at the end of the day.

MR. SAUNDERS, PRESIDING CHAIRMAN: It sounds like a good idea, Mr. O'Flaherty, and we'll come back at 10 after, thank you.

(break)

(12:15 p.m.)

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay, Mr. O'Flaherty, if you're ready.

MR. O'FLAHERTY: Thank you, Mr. Chairman. That was very valuable. I think I can cut right to the quick on this.

MR. SAUNDERS, PRESIDING CHAIRMAN: Good.

MR. O'FLAHERTY: On page 7.2, I can take you to, of the exhibits, which are in Appendix A. Now, you want to look at the, to the FA over industry number on the top set of data, okay, the 1.8054 ...

MR. PELLY: Yes.

MR. O'FLAHERTY: ... that you have there? Now, as I understand it, that number is derived from the division or the ratio between the Facility ultimate loss cost and the industry ultimate loss cost, am I correct?

MR. PELLY: You're very close.

MR. O'FLAHERTY: Okay.

MR. PELLY: The 1.8054 is the average of the five values appearing above it.

MR. O'FLAHERTY: Right, okay. I skipped a step. So ...

MR. PELLY: Each of ...

MR. O'FLAHERTY: Yeah. So if we take ... sorry, I didn't mean to interrupt you but I did promise the Board that I would move this quickly, the bunch of questions. If you take the bottom two numbers on the ultimate loss cost column, the vertical columns which are in between the distribution and the risk factor for industry, and which are above it, directly above it, you have 1, at the very bottom, 1,354.01 and 644.46, correct?

MR. PELLY: That's correct.

MR. O'FLAHERTY: And if you do the ratio between them, you get 2.1010.

MR. PELLY: Yeah.

MR. O'FLAHERTY: Which is that number there in the next vertical column to the right, which is FA over industry.

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay. Now, that is the number then, as you pointed out, that derives the ultimate risk factor by a straight average of the five similar ratios that would be calculated.

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay. So you take that number and we go down here to your note, as you've called it. The 1.8054 has been derived from the ratio of those two numbers. So would you agree then that the 644.46 on the bottom industry column already takes into account the 1.814 distribution number? In order to get to 644 you have to multiply it by 1.8.14 *(sic)*.

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay. Now, then when we move the, you move over, the rest of your calculation, isn't the 1.8.14 also included again in the calculation?

MR. PELLY: Maybe if you could rephrase your question for me? When I move to the rest of the calculation ...

MR. O'FLAHERTY: Back down to the note, the 1.8.054 *(sic)*, this is the, this factor equals credibility weighted average of average ...

MR. PELLY: Yes.

MR. O'FLAHERTY: ... FA over industry ratio and current risk factor, okay.

MR. PELLY: Yes.

MR. O'FLAHERTY: So right now does your denominator account for the 1.814 distribution factor?

MR. PELLY: The denominator in the 1.8054, the implied denominator in that value?

MR. O'FLAHERTY: Yes.

MR. PELLY: Yes, it already accounts for that in the denominator.

MR. O'FLAHERTY: Okay. And is it also accounted for again in the calculation?

MR. PELLY: Well, the 1.8054 is used again, is used in that calculation on the second line of the footnote.

MR. O'FLAHERTY: Right.

MR. PELLY: So it's there in that, just like it was there when it appeared in the table above.

MR. O'FLAHERTY: So do you see the number 1.8.14 in the distribution being used twice in this particular calculation to get to the ultimate risk factor that we're talking about here?

MR. PELLY: No, but I think there must be some misunderstanding arising and perhaps that's my failing. Maybe the way to think about this is to just look at the flow going across the page for the industry data. By the time we get to the column labelled "Ultimate Loss Cost" or ULT, LC, for the industry data, and let's take the 2001 accident year as an example, we have a value of $644.46 and that includes, that is after adjustment for the distributional difference. The next factor that gets applied to that is the risk adjustment, which is a value of 1.8015, and it's my contention that that is net of or excluding the effect of the distributional adjustment. That is applied to the 644.46 to give you the 1,160.99. Why do I say 1.8015 is excluding the distributional adjustment?

MR. O'FLAHERTY: Yes, that's a key question.

MR. PELLY: Or is net of the, however the right way to phrase that is. Well, we need to look down below at the footnote. 1.8015 is in effect a weighted average of two values, 1.8054 and 1.6738. The weightings used to combine those two values are, is a credibility statistic that gets attached to the 1.8054. That's the value of .9705 that appears there. The balancing weight that gets applied to the 1.6738 is a .0295, which is simply the difference between the first credibility factor and 1. So the 1.8015 comes from averaging two values. One of those values is 1.8054, which is already net of the distributional adjustment. The other value is 1.6738, which is correspondingly net of the distributional adjustment but from the prior year's analysis.

MR. O'FLAHERTY: Okay. I'm going to move on from that topic now and I'll promise not to return to it in the next five minutes anyway, Mr. Chairman. I want to talk to you just briefly about another issue with you in the expenses, sorry, in the premium section of this particular ... sorry, expenses and underwriting margins, which is found at page ten of the filing.

MR. PELLY: I have that.

MR. O'FLAHERTY: Now, what is the effect of the discount rate or the relative value of the discount rate on the cash flow model that you're using here?

MR. PELLY: You said the relative value. Is there a significance to ...

MR. O'FLAHERTY: Well, if it's higher or lower, what happens?

MR. PELLY: The higher the discount rate, the more contribution that is expected from investment income arising on the cash flow from insurance operations and therefore the less premium income would be required to feed that process. If more can be expected from investment income, less would be needed, all other things being equal, from premium income.

MR. O'FLAHERTY: Okay. So if the discount rate was listed at, for example, 6 percent as opposed to 5.4 percent in this particular case, then that would tend to drive the premium required downwards, wouldn't it?

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay. Well, I'll just point this out anyway in fairness. It appears that the discount rate used in the previous analysis was not 5.5 percent, at least that's what I'm able to find, unless it was used on an updated basis, because it appears to indicate 6.1 percent in your document.

MR. PELLY: Well, this is a confusion that your expert and I have had in a couple of jurisdictions. The word that's used there is "analysis" as opposed to "filing."

MR. O'FLAHERTY: Okay.

MR. PELLY: Previous analysis, which was the one based on the 2000 AIX, used 5.5 percent. The last previous filing, which in the case of Newfoundland and another jurisdiction where your expert was involved, was based on the 1999 AIX primarily, and the discount rate used in the 1999 AIX analysis was higher still. You may be right about the 6.1.

MR. O'FLAHERTY: Okay. But I just was going to point that out. And that would have been one of the factors that was taken into account for the purposes of deciding on the discount rate in this particular case.

MR. PELLY: Which would have been one of the factors.

MR. O'FLAHERTY: The discount rate used in the previous analysis.

MR. PELLY: That's correct, as listed.

MR. O'FLAHERTY: As opposed to the filing, that's your point. Yeah, okay. The top of the page, the provision for return on surplus in the derivation of the indication is zero percent. Now, why is the derivation for the return on surplus, sorry, why is the provision for return on surplus in the derivation zero percent?

MR. PELLY: We can use the expression "profit provision" for this, is probably more intuitive, and the answer is that it's zero percent based on instructions I have received from Facility Association's Board of Directors in that regard.

MR. O'FLAHERTY: And have those instructions been consistent since the involvement of Eckler Partners Limited with Facility Association in this jurisdiction at least?

MR. PELLY: Yes.

MR. O'FLAHERTY: And harkening back to your previous involvement with your, the different manifestations of your previous employer, were those instructions the same?

MR. PELLY: They were but the instructions get revisited periodically by Facility Association's Board of Directors and so far they have been reissued each time.

MR. O'FLAHERTY: Okay. I'm not going to ask you any questions about the rationale for that. I just want to look at this in terms of a financial model. So would you agree then that the, all things being equal, and I appreciate when you're looking into the future, you know, this is an imprecise model, but the goal is to have no surplus or ... what was the term you used, profit?

MR. PELLY: Profit provision was ...

MR. O'FLAHERTY: No profit provision, all things being equal at the end of the, a future rate period.

MR. PELLY: The objective ... the difficulty in my offering you a response is that it needs to have a context and I guess it's up to me to provide the context. In the rate-making context zero percent profit provision means that on an expected basis the premiums in conjunction with investment income arising on the cash flow from insurance operations will be just adequate to meet the expected cost of claims and the expected other expenses, so in theory when the last claim gets closed, the last dollar gets spent. That's all on an expected basis. When you move over to the financial reporting context and in particular exhibits like the Statement of Operations for Facility Association, residual market, or the provincial breakout of that information, the zero percent profit provision that is recognized in the rate-making context will give rise to an expectation for a positive excess of revenue over expenses in the context of Facility Association's financial statements, and that arises because of the sharing mechanism that is fundamental to Facility Association. Member companies incur expenses arising from their participation in Facility Association. They incur those expenses directly and they appear as expenses in their own member company financial statements. The revenue source that is intended, at least in theory, to finance those expenses incurred by those member companies is a part of the premium dollars, and this is for things like the premium tax or the health levy or industry and association dues, anything that are levied on the insurance industry on a basis that is inclusive of their share of Facility Association, the consequence being that for those member companies to be made whole, to be, I hesitate to use the word "reimburse," because it's not really that process, but to be, to have funds made available for purposes of meeting those costs, although it's done on a delayed basis for premium taxes and the like, you need to have a positive result from operations in Facility Association.

MR. O'FLAHERTY: And can you just refer to page ten of the filing? I guess we'll move back there. This particular table which is shown, are these the items, the categories of items that you're referring to that it's necessary to generate the positive amount of money over and above zero percent in order to reimburse for these necessary expenses?

MR. PELLY: Only in part.

MR. O'FLAHERTY: Only in part.

MR. PELLY: Premium tax is one example I've provided.

MR. O'FLAHERTY: Yes, you did, yeah.

MR. PELLY: Health levy was a second example that I provided, and the other example that I gave was industry and association dues, which is a fairly minor item and is basically buried within operating expenses, I suppose, but it's a small item as a percentage of premium.

MR. O'FLAHERTY: And I don't want to get too hung up on this point. I mean, this may be relevant at some other stage, but for right now what I'm trying to understand, you've listed first of all profit as an expense, okay, and I don't want to get into the theory of that, but at the end of the day is what, what you're saying is that once the expenses, we have to generate enough revenue through Facility to pay the expenses of each of the members that are incurred as a result of there being members within Facility, direct expenses, and then, all things being equal, you should be left with a break even position. That's the direction from the Board of Directors.

MR. PELLY: As we were directed for this application, yes.

MR. O'FLAHERTY: So that fairly states the situation.

MR. PELLY: Yes.

(12:30 p.m.)

MR. O'FLAHERTY: Okay. Now, are any ... I know you indicated that you do an annual review process, automatic annual review process for, on behalf of Facility Association, is that correct?

MR. PELLY: With respect to private passenger commercial vehicles in all jurisdictions in which Facility Association operates, yes. It's ... you could call it automatic. It's a planned event each year.

MR. O'FLAHERTY: And through that process a decision gets developed on whether or not to come forward with a rate filing, I take it?

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay. You don't come forward with the rate filing annually, at least I'm not too much concerned with other jurisdictions, I'm concerned with Newfoundland and Labrador, you don't come forward with a rate filing annually.

MR. PELLY: Not necessarily, no.

MR. O'FLAHERTY: Okay. So you've been in operation or FA has been in operation in this jurisdiction for, I think this is the seventeenth year.

MR. PELLY: Sounds about right.

MR. O'FLAHERTY: 1985, November 1st of 1985 was the ... so strictly speaking we are into the 18th year. Of those 17 years can you estimate for me how many years that you've brought forward rate filings, and I only ask you that question because you did have this background with Facility yourself. I'll certainly ask Mr. Simpson the same question if you don't know the information.

MR. PELLY: I'd be surprised if Mr. Simpson had that at his fingertips either. I do have a chart that takes me back a distance but I don't know that it's far enough. Let me just check. The information that I have available only takes me back to a rate change that took effect in 1990, which was for private passenger vehicle then for commercial vehicles, so that's not going to be sufficient to answer your question because there's obviously filings prior to that.

MR. O'FLAHERTY: Okay. Is that a document that's part of the Board's record?

MR. PELLY: No. That's a personal record that I keep for my ...

MR. O'FLAHERTY: Okay, because I haven't seen that. Can you tell me, and this will be the last question on this particular point, can you tell me how many filings have been made since 1990?

MR. PELLY: Well, the first filing that I was referring to was a filing that became, the rate level that became effective in July of 1990, so the filing would have been made probably in 1989 if that's, adds any value to this answer. And for private passenger vehicles there have been eight rate level revisions including the one which became effective in May 2002, for private passenger vehicles, and six such rate revisions that have taken effect, including that, the latest one being effective in 1996.

MR. O'FLAHERTY: Okay, thank you very much. Now, I want to touch on a couple of topics that are under the heading "Premiums," 2.8.

MR. SAUNDERS, PRESIDING CHAIRMAN: Appendix A, Mr. O'Flaherty?

MR. O'FLAHERTY: Yeah, it's the narrative portion, page ...

MR. SAUNDERS, PRESIDING CHAIRMAN: Oh, I'm sorry.

MR. O'FLAHERTY: Page 12.

MR. SAUNDERS, PRESIDING CHAIRMAN: Page 12, 2.8. Yes, I have it.

MR. O'FLAHERTY: Now, the topic I want to touch on I realize spills over into the proposal to impose or to institute the CLEAR rating system here in Newfoundland, so it is sort of about both of those topics, but I want to talk to you a little bit about the use of premium drift assumptions. This is an issue for the optional physical damage coverage, I take it.

MR. PELLY: Yes.

MR. O'FLAHERTY: And the issue of the premium drift in this particular filing is largely driven by the proposed introduction of CLEAR, isn't it?

MR. PELLY: No.

MR. O'FLAHERTY: Okay. The difference between the premium drift that's proposed in this case and the one in the last filing is largely driven by the introduction of CLEAR, isn't it?

MR. PELLY: No.

MR. O'FLAHERTY: Okay. In the last filing, what was the premium drift level that was suggested?

MR. PELLY: Much lower. For collision it was 2.8 percent per annum, for comprehensive it was 2.9 percent per annum, and for specified perils it was assumed to be zero percent.

MR. O'FLAHERTY: And this years it's 10.63 percent?

MR. PELLY: For rate group drift specifically, yes.

MR. O'FLAHERTY: So I'm ... there's a terminology issue then that we need to deal with obviously.

MR. PELLY: Would you like me to explain why I said no?

MR. O'FLAHERTY: I would like you to explain it, thank you.

MR. PELLY: Happy to do that. Starting about two years ago the Vehicle Information Centre of Canada made a significant procedural change to the manner by which it updates the tables used to assign vehicles to rate groups when it's part of a rate manual and users of the rate manual make reference to this table to determine what rate group a particular vehicle make, model and model year should be assigned to. VICC is one source for these rate group tables, probably the dominant source in Canada. They made a change to the method that they used for updating those tables because they're, they need to be updated at least once a year to recognize that there are new makes and models and model years on the street, and so they need to encompass those within the tables. That's the reason why they get updated. Several changes were introduced to the methodology employed by VICC for doing that update and I have only passing familiarity with the details of the changes that were made, but the consequence of the change, changes, is that there's an expectation for a much, much higher level of premium drift under this new world of the way the, the manner in which the tables are being updated than existed previously to that. The 10.63 percent factor that we've adopted in this application is an advisory number provided by VICC. It was my evidence that I believe that factor is a little bit high for Facility Association but I have no means at my disposal to determine how high, so with some cautious reluctance we proceeded with the use of that factor and certainly advised the various committees within Facility Association that that was what we had proposed, so that it could be considered at the time when the application is being made. As I testified, if I'm correct, that the rate group drift factor as used is high, then the rate level need is being understated for the physical damage coverages. I can't prove that it's high and I don't have an alternative basis for the assumption, so I've used it and I've run the risk that I have in fact understated the physical damage rate requirement as a result. So the change in the methodology employed by VICC was, that change was made both with respect to CLEAR and with respect to the former style of table, which are sometimes called the manufacturer's suggested retail price, or MSRP tables, and the CLEAR and the MSRP current rate group drift assumption levels being promulgated by VICC are much much higher than was the case a couple of years ago.

MR. O'FLAHERTY: Now, you also indicated, I believe, in your testimony that due to these uncertainties about the size of the rate group drift, which is related to giving the age of the data you used, I believe you used two year old data for the, or VICC used two year old data, the 2000 AIX, and given the character of the fleet, I think that was another issue that you had mentioned, your anecdotal understanding or belief that there were older vehicles in the fleet or different vehicles than in a regular fleet, your indication was that FA would have addressed this through the proposed premium aspect of the filing. Am I correct on that?

MR. PELLY: I think you mixed a few thoughts together there.

MR. O'FLAHERTY: Okay.

MR. PELLY: I think the reference to what VICC did for us was in the dislocation study and that really didn't have anything to do with the rate group drift factor that was selected here.

MR. O'FLAHERTY: Okay. Well let me focus on the rate group drift then because I understood in answer to a question from Mr. Stamp that you indicated that you weren't comfortable with this particular number for the reasons you've just indicated to the Board, but that in response to your lack of comfort that FA had responded through, or could have responded or, you know, through the mechanism of looking at the gap between indicated and proposed rate level changes. Am I correct on that?

MR. PELLY: That's correct.

MR. O'FLAHERTY: Okay. So can you tell us how that works? You communicate to them your lack of comfort with the number and then the response in terms of numbers is contained in the proposed rate level changes, I take it.

MR. PELLY: Well, just to give you a flavour for that, let's just try and bear in mind that my premise was, and this was widely supported by Facility Association's actuarial committee as well, the premise was that the physical damage rate indications were likely understated, so either not a large enough positive number or are too large a negative number. That's what I mean by understated. So if we look at page one of the application, and that's the narrative portion, the theory behind that premise is that the values appearing in the columns for collision and comprehensive for private passenger vehicles, or if we take the overall value of minus 5 1/2 percent for collision as being the indication and minus 14.1 percent for comprehensive, that those values are too negative. We're not sure by how much. One option that Facility Association considered was to put in place a capping, perhaps limiting the extent to which that downward indication was going to be recognized for purposes of putting forward a proposal. Now, in this instance you will see that the collision and comprehensive proposals are the same as we indicated, so they came to the conclusion, the committee, the Rates and Rules Committee and then endorsed by the Board of Directors, that that wasn't a step that they were prepared to proceed with in this instance, that they were prepared to go forward with the proposed and basically override the concern that I had.

MR. O'FLAHERTY: Okay, thank you for clarifying that. I take it then that the rate group drift is part of the premium drift but is not, does not contain the whole of the premium drift?

MR. PELLY: In that table that you had us at before ...

MR. O'FLAHERTY: Correct.

MR. PELLY: ... Mr. O'Flaherty, summarizes the factors for other portions of the rate group drift, sorry, the premium drift, namely limit and deductible drift, and then the final column shows the combined impact where there's something to combine. There's a table at the foot of page 12 of the narrative and the top of page 13 for commercial vehicles. And this whole issue of rate group drift that we've just been talking about is only a private passenger issue, CLEAR and the updatings process for rate group table, that's all private passenger context. Commercial doesn't have that same problem.

MR. O'FLAHERTY: Yeah, and I do have a couple of questions on those issues. I'm pleased Mr. Simpson is testifying (inaudible) Facility as well. The next section of your, of the filing, which is Section 2.9, this appears to be a new section that doesn't appear in the other last two filings. What is the purpose of this particular section of the filing?

MR. PELLY: The principal objective of this section is to provide a little bit of commentary about each of the building blocks that is used to construct the provincial indication, provincial indicated change in average rate level. This was introduced following commentary received on an application in another jurisdiction, for what's it worth, by your expert on a previous occasion, and we responded to that by putting in additional documentation in the narrative because it was felt at that time by the user of this document, the regulator, that that was, that would be helpful, so we sought to do that.

MR. O'FLAHERTY: So it's an expanded summary of the previous information regarding the provincial rate level indications.

MR. PELLY: Yes.

MR. O'FLAHERTY: Okay, thank you. Now if you move over to the territory indications, I just have a couple of questions about this. It appears that the territorial indications are based on 2000 AIX data.

MR. PELLY: That's correct.

MR. O'FLAHERTY: And is the 2001 AIX data presently available?

MR. PELLY: Yes, it is.

MR. O'FLAHERTY: It is available, okay. But it was not available, I take it, at the time that your particular review for this, for the purpose of this rate filing application began.

MR. PELLY: That's correct.

MR. O'FLAHERTY: And in terms of the territorial rate level indications, is there a, are there coverages in which there are no distinctions drawn between territory whatsoever?

MR. PELLY: For rating purposes?

MR. O'FLAHERTY: For rating purposes.

MR. PELLY: Presently, yes.

MR. O'FLAHERTY: And what are those coverages?

MR. PELLY: For Facility Association it's accident benefits and uninsured automobile.

MR. O'FLAHERTY: And is that the same situation with the benchmark?

MR. PELLY: No, it is not.

MR. O'FLAHERTY: So it is broken down separately by territory in the benchmark for both those coverages or for one or the other of them?

MR. PELLY: Only for accident benefits is it not territorially rated, but for uninsured auto it does make provision for territorial rating.

MR. O'FLAHERTY: Okay. I found on some of your answers yesterday you had indicated that there could be an issue of an unfair burden falling upon, and I don't mean to mischaracterize your words, upon certain territories or a disproportionate burden of premium falling on some territories rather than others in one particular coverage at least. Do you recall that testimony?

MR. PELLY: I do. Basically it's a consequence of not recognizing experience. If you choose to flatten the premium that you charge across a body of, a group of policyholders or risks, by its nature you're assuming that they are all similar and you are charging the same premium for all of them. The principle of classification is that it becomes more fair to break those policyholders into cohorts, little groupings, and within each grouping they become more homogeneous and you can assign, determine a premium and assign a premium to those more homogeneous groupings that becomes a more fair representation of the risk profile that they present to the system. Territorial is one example of classification rate making. Facility Association's position on this has been and continues to be through this application that they don't want to lead market practice, they don't want to be a trend setter, so they want to wait to see that market practices gravitating towards territorial rating of accident benefits before making that move themselves, and their latest assessment of that suggested to them that that was not common practice here yet. That may in part be because of the benchmark, I don't know, so until such time as they see stronger evidence of this being at least an emerging if not dominant practice for territorial rating of accident benefits, I fully expect that Facility Association will resist the temptation to react to the experience. Our purpose in presenting that experience and the advice about the territorial rating of accident benefits was simply advisory. If that has any influence on the way the benchmark evolves, then that may be a good thing, but nevertheless the day may come when the Facility Association will be bringing forward such a proposal and this is strictly sort of an advance notice of that possibility.

(12:45 p.m.)

MR. O'FLAHERTY: So would you agree then that from an actuarial perspective you'd see this as a possible improvement to the precision of the actual rate distribution across Newfoundland and Labrador?

MR. PELLY: I really dislike the word "precision."

MR. O'FLAHERTY: Okay.

MR. PELLY: But I think it would be an improvement to the "fairness."

MR. O'FLAHERTY: And I specifically picked precision because I figured if I said fairness that that would be an area that you wouldn't be qualified in or wouldn't comment on. Fair enough. So you see it as a fairness issue too.

MR. PELLY: I do.

MR. O'FLAHERTY: Okay. So in other words, that consumers in Territory 2 shouldn't be subsidizing consumers in Territory 1 when there is information available which indicates that the rate level indications are higher for one territory over the other.

MR. PELLY: It's strong and persistent evidence.

MR. O'FLAHERTY: Yes, strong and persistent evidence like you demonstrated yesterday.

MR. PELLY: Yeah.

MR. O'FLAHERTY: Okay. Now, what about in a situation with uninsured auto coverage, the $19? Facility ... that is broken down in the benchmark, is it, by territory?

MR. PELLY: It is.

MR. O'FLAHERTY: But in Newfoundland and Labrador Facility is not proposing to break it down by territory.

MR. PELLY: Once again that's a function of what they perceive to be current market practice. They don't want to lead the way, they want to follow and they're waiting for it to at least be emerging as a dominant practice, if not a dominant practice.

MR. O'FLAHERTY: Is there an indication, sorry, not an indication, is there an effort by Facility Association to have a consistent premium of $19 right across the Atlantic Provinces, jurisdictions in which they operate?

MR. PELLY: I wouldn't say that's the intent, that's not the focus. The use of New Brunswick experience in the calculation of the uninsured automobile proposal for commercial vehicles was a fall-back position. The preference would be to use jurisdictional data.

MR. O'FLAHERTY: Okay, yeah, and I should be asking Mr. Simpson about that anyway. That's fair enough. In terms of the next section, Section 4 of the report, sorry, of the filing ...

MR. PELLY: Section 4 or 5, did you say?

MR. O'FLAHERTY: Section 4 ...

MR. PELLY: 4.

MR. O'FLAHERTY: ... of the filing.

MR. PELLY: Yes.

MR. O'FLAHERTY: Page 19 and following.

MR. PELLY: I have that.

MR. O'FLAHERTY: Now, in terms of the increased limit and deductible differentials, what would be the effect of, on the premium volume of increasing the limit and deductible differentials?

MR. PELLY: Let me make sure I understood your question. What would be the effect on ...

MR. O'FLAHERTY: I don't believe ... it's not a premium issue, is it, in terms of increasing deductibles?

MR. PELLY: This is the increase in the minimum deductibles?

MR. O'FLAHERTY: Yes.

MR. PELLY: It has an impact, all other things being equal, if you have a period and then change the minimum deductible, then have a, and then repeat the same period. Anybody who had a premium below the minimum previously, who had a, not a premium but a deductible below the minimum, will be changed in that restatement of that period to a higher deductible, so if you can really conceive of an all other things being equal scenario, then the premium volume after the implementation of higher minimum deductibles will be lower by virtue of the fact that you are providing less coverage in exchange for a lower premium. That's the consequence of increasing minimum deductibles. Certain policyholders who had deductibles that were below the new minimum will be moved up to the minimum and therefore pay a lower premium.

MR. O'FLAHERTY: I see the perspective, okay. But on a go-forward basis, you know, once we get past this next premium year, sorry, the next filing year, is there an impact following that ...

MR. PELLY: No.

MR. O'FLAHERTY: ... in terms of the premium? No.

MR. PELLY: I mean, other than limiting options of ...

MR. O'FLAHERTY: Right.

MR. PELLY: ... open to Facility Association policyholders.

MR. O'FLAHERTY: Okay. And this is not an issue that's based on an actuarial analysis of loss experience.

MR. PELLY: No, it's not.

MR. O'FLAHERTY: Okay. Is this, to your knowledge, an issue of behavioural modification?

MR. PELLY: It has elements of that.

MR. O'FLAHERTY: Okay. Can you explain your understanding of that?

MR. PELLY: Certainly. Take an extreme case where there's a zero dollar deductible provided on a physical damage coverage. Under those circumstances, claimants will bring forward every claim because every claim is subject to indemnification. Every claim will involve some that are very minor, certainly across the whole body of claimants it will, and that almost defeats the purpose of insurance. There are administrative costs associated with running an insurance company and administering and adjusting claims and it's conceivable that if you have a, you know, a little scratch on the back of your car that can be fixed with a little bit of buffing, if you pay somebody to do that and process it as a claim under your comprehensive coverage, the cost of doing that is, the expense portion let alone the actual claim piece, is just astronomical compared to the value that actually comes out of the process, so you don't want insurance to deal with that. You really ... it's impractical for insurance to deal with that. So deductibles are there in order to cut out the small claims, because insurance isn't really there for that purpose. Beyond that it's also used in some respects as an underwriting tool in order to encourage good behaviour by making the deductible at a level people are, would want to avoid incurring the deductible and therefore perhaps improve their driving habits by avoiding accidents, so there is a behaviour modification side to it.

MR. O'FLAHERTY: And to your knowledge, and I know you haven't, there's no, you know, loss experience that you can analyze, so maybe you can tell me intuitively to answer this question. Does this also have an effect on the loss costs that are paid by Facility?

MR. PELLY: Yes, it does.

MR. O'FLAHERTY: And what is that effect?

MR. PELLY: This that we're talking about is ...

MR. O'FLAHERTY: The imposition ...

MR. PELLY: ... the imposition of a minimum deductible.

MR. O'FLAHERTY: ... of minimum deductibles and raising the existing deductibles.

MR. PELLY: Yeah, it has the possibility of lowering the loss costs if more claims will be eliminated by a higher deductible. It's a relatively minor impact of course because most people in Facility Association, if they're buying physical damage, which is not a common thing to do in Facility Association, most policyholders do not buy physical damage coverages. Those that do tend to gravitate towards higher deductibles, so it's a relatively small pocket of Facility Association policyholders who'll be impacted by this change, particularly in private passenger vehicles.

MR. O'FLAHERTY: Well, can we move then to an area which could have quite a significant impact, and that's Section 5 of the filing? Now, I also understand that this is, if I'm correct, this is a proposal for which there is no actuarial analysis of loss experience.

MR. PELLY: That's true, other than in quantifying the estimated rate level impact of the proposed change.

MR. O'FLAHERTY: Yes, I agree. And perhaps you can start there. What is the effect?

MR. PELLY: As an integrated package, the changes to the accident conviction surcharge schedule and the clean driver discount is estimated, all other things being equal, would add about 1.3 percentage points. Now, the actual manner in which this has been pulled into the analysis is that we give recognition to the expected contribution about those changes when we are putting forward the proposed base rates, so if we are seeking an overall for a particular territory and coverage, it's affected by this schedule. If we're seeking an overall change of ten percent and we think that 1.3 percentage points will come from the implementation of this change, then we need to get the rest of the ten points of change from some place else, and part of that may be from changes in other differentials, but whatever is left over at the end needs to come from a change to the base rate. That's the manner in which this has been integrated in. That was my answer for private passenger vehicles. The corresponding estimate used in commercial vehicles is about 6.4 percentage points. The reason why the commercial one is higher is because there is no clean driver discount component to the proposal for commercial vehicles.

MR. O'FLAHERTY: You say there is no clean driver discount applicable in the proposal for commercial vehicles?

MR. PELLY: That's correct. It's a private passenger only feature.

MR. O'FLAHERTY: Now, how does this proposal compare to the proposal ... is this a proposal consistent with the proposals put forward in Nova Scotia and New Brunswick?

MR. PELLY: Yes, it is.

MR. O'FLAHERTY: And is this consistent with the proposal put forward in Ontario?

MR. PELLY: Yes, it is.

MR. O'FLAHERTY: I think I'll defer my other questions on this to Mr. Simpson about this particular area. Can I just turn finally to the CLEAR imposition ... I know we touched on it in the rate group drift in the issue of the imposition of CLEAR. Now, one of the issues that's of concern is the nature of the FA book of business under this particular proposal, would you agree with that?

MR. PELLY: Or is a generic issue for the implementation of CLEAR. I would use the word "implementation" rather than "imposition," but as a generic issue, dislocation, policy premium dislocation is an issue. At the time when it was first sort of being launched by the industry, there were studies done that provided graphs comparable to the one that I provided on ...

MR. O'FLAHERTY: The one that's with the letter from Mr. Simpson?

MR. PELLY: Yes, it is, but, I mean, I included it.

MR. O'FLAHERTY: Oh, you have it as well, okay.

MR. PELLY: Page 11 of BGP 3 is a graphical presentation of the dislocation study prepared for this particular application. I can recall seeing similar sorts of graphs that were generated using industry typical distributions at the time when CLEAR was first being promoted and implemented by various companies, and the distributions were not nearly for voluntary market or for industry type expected scenarios. The distribution was not nearly so concentrated. It was much more diverse and you saw fairly significant pockets of exposure with large, like plus, certainly greater than the Ontario regulatory threshold, large pockets of policyholders in percentage terms seeing significant dislocation, both upward and downward. We're not seeing that here and that's a large part of the reason why I expressed the view that Facility Association's fleet of vehicles is fundamentally different. The other reason is the information that was provided by VICC with the dislocation study, this showed the distribution by the age or by the model year of the vehicle and it was clearly skewed towards older vehicles, something which didn't hold true when I walked outside.

(1:00 p.m.)

MR. O'FLAHERTY: Now, subject to of course the issue about the data being, you know, two years old, what does this tell us about the dislocation in terms of numbers of persons insured through private passenger vehicle and commercial in terms of dislocation? Are more people likely to see a positive dislocation in terms of increased premium rather than a lowered premium because of the imposition of CLEAR?

MR. PELLY: First of all it won't affect commercial vehicles.

MR. O'FLAHERTY: Sorry, okay.

MR. PELLY: This is a private passenger only phenomena. Secondly, this implementation of clear is being done coincident with a rate level change, so when I talk about revenue neutral implementation of CLEAR, that's a concept that is being used to quantify the extent, the rate level impact of CLEAR, but this application is also dealing with a rate level request.

MR. O'FLAHERTY: Right.

MR. PELLY: Policyholders that are currently in Facility Association who are renewed in a subsequent rating period under the new rates will not be able to separate those two effects because they just get a new premium, they know what their old premium was and the change will be whatever it is. Probably the best way for me to try and give you something meaningful as a response is to refer to the bar chart. The people on this bar chart, if you accept that the population is 100 percent, about 68 percent of the policyholders would be expected to receive a downward movement attributable to the implementation of CLEAR, a very very small, like .53 percent, would be expected to see no movement attributable to the implementation of CLEAR, and then the balance, which would be about 31 percent, would be expected to see an upward movement in their premium attributable to the implementation of CLEAR, and that is apart from, in all three cases that I just cited, that's apart from whatever rate level change is being implemented.

MR. O'FLAHERTY: And how does that percentage break-out affect the imposition, sorry, the implementation of a revenue neutral approach from the Facility Association?

MR. PELLY: In some jurisdictions they ask that rate applications for the implementation of CLEAR be standalone, that it only be dealing with CLEAR, so that the issue of dislocation can be examined on an isolated basis, and that's the way we originally proposed it in this jurisdiction, and we were asked to combine our rate application, because there was also one of those coming, with the CLEAR implementation application.

MR. O'FLAHERTY: Okay.

MR. PELLY: So we followed that instruction.

MR. O'FLAHERTY: How do you deal with the fact that it looks like, all things being equal, if CLEAR is implemented in the jurisdiction, that some 70 percent of the persons would receive, or 68.5, you've just roughly indicated, would receive a lower, would be subject to a lower premium when you're dealing with revenue neutral implementation?

MR. PELLY: Well, that has to do with, and we can get that impression from this graph. Actually before I'd offer that explanation, my answer to the previous question was the direction of the influence of implementation of CLEAR, because there is a rate level change being proposed at the same time, so that's the first clarification. The other clarification is that if you look at page 11 of BGP 3, as a quick observation from that chart, you can identify where the zero point is by looking at the horizontal scale. It's not actually labelled as being the zero point but there are points with negative signs to one side of it and points with positive signs to the other, so zero is in the middle there. The bars to the left of that zero point are higher, more volume in there, but more concentrated to zero, so they do not spread out as far to the left as the points on the right do going to the right of the zero point, so although there are more people to the left, they aren't as far to the left as the fewer people on average are to the right of the plus sign, so the weighted average of those two is zero. You've got a fewer number of people with on average more dislocation in a positive direction versus a larger number of people with a smaller average dislocation in a negative direction. The average of those two is zero.

MR. O'FLAHERTY: I understand. How are you accounting for or taking into consideration the decline in Facility's business in the province when you make this calculation?

MR. PELLY: In terms of the volume?

MR. O'FLAHERTY: In terms of the volume.

MR. PELLY: And this calculation being the dislocation?

MR. O'FLAHERTY: Yes.

MR. PELLY: We're not.

MR. O'FLAHERTY: Is there a reason why you're not?

MR. PELLY: At the time when the dislocation study was undertaken, which was, we began the process of trying to make it happen, I would approximate the summer of 2000, we began the process, and that involved contacting all of the servicing carriers and first identifying on what basis their systems would be capable of implementing CLEAR and what constraints they face in terms of being able to move towards CLEAR, whether they had done it with their own systems for their own company book and whether that translated to being able to do it for Facility Association, because we needed to know that we can go there, that it's a place we can get to practically speaking, and in those cases for those isolated servicing carriers that faces, face some limitation, how extensive a process it would be for them to be able to overcome that limitation with, say, systems development. The second part we needed to talk to the servicing carriers about was being able to provide us with an in force file that we could feed into the VICC's dislocation study process. That was a big undertaking for several of the servicing carriers. We were doing this in all jurisdictions so we were dealing with more than just the Newfoundland four servicing carriers. We eventually settled on a date of December 2000 as being the date on which we wanted each servicing carrier to prepare an in force file and we had had some discussions with VICC prior to this time but we, once we knew the date we then continued with our discussions on a more intense basis with VICC with respect to what we needed them to do, because it was a bit special for them as well. They are accustomed to the extent that they provide this service to the industry of getting one in force file, and we needed them to be able to take an in force file from each of the four Newfoundland and Labrador servicing carriers and combine them. For reasons which I do not claim to understand, that was a problem, so we had to overcome that problem with them by helping them with it. They also had some resource allocation problems and there were some issues of timing for them that proved challenging, and eventually we got dislocation studies starting to be fed back to us. We had to prioritize which jurisdictions we wanted first and in this particular instance, Ontario was the first one and the reason for that was that CLEAR as a widespread adopted practice in the industry was far more advanced in implementation across the industry in Ontario than anywhere else, so we needed to move there fastest and that's what we did, and then we dealt with successive jurisdictions step by step. That meant working towards making an application to implement CLEAR as we were able, and the CLEAR, or the initial application to this Board to implement CLEAR I believe was in a letter sent in the summer of 2002, and it was following that and some discussions on that line when it came time to put this rate application in as well that we were told to combine the two.

MR. O'FLAHERTY: Sure. So would you agree then it's not an ideal scenario to use the two year old policy in force file, especially due to the changing volumes of business in Newfoundland, questions about the fleet, when you're looking to impose CLEAR, sorry, when you're looking to have the CLEAR system implemented in Newfoundland and Labrador?

MR. PELLY: It's not ideal but it's a practical alternative.

MR. O'FLAHERTY: But because of the uncertainties that we've identified, and we seem to agree that those uncertainties do exist, would you accept that it is reasonable for the Board to look at phasing in the effects of these particular premium changes on Facility, consumers in the province?

MR. PELLY: I don't think I can take that leap.

MR. O'FLAHERTY: Okay.

MR. PELLY: The evidence of the December 2000 in force file is that very few policyholders would have faced significant dislocation had we been actually implementing CLEAR on that date. The most significant parts of the extreme dislocation that arises from CLEAR implementation as a generality are not on older vehicles. There are some exceptions but most of the cases are on the more modern vehicles, and it's either because they are costly and very expensive to repair, maybe the BMWs or the Lamborghinis (phonetic) or something like that, or because they have very effective crash protection technology built into them, in which case the MSRP system does not adequately capture that. The MSRP system would tend to push them into a higher rate group and that's not giving proper recognition to the benefits of some of the things that makes them more expensive, so that's mostly in the more modern vehicles and that's why the bigger dislocation is expected in the voluntary market setting as opposed to Facility Association setting.

MR. O'FLAHERTY: Okay. Well let me see if we can agree on this. Would you agree that it's more reasonable for the Board to consider phasing in the effect of this particular implementation given the circumstances that exist about the policy in force file and the uncertainties about the fleet than it would in a circumstance where the policy in force file was much more current?

MR. PELLY: I think there are alternative courses of action open to the Board that are preferable. If they remain uncomfortable about relying on the indication from using an older in force file, I think there are other options rather than imposing the capping process, that are more effective or at least will give rise to a better ultimate decision. One of those options would be to defer implementation of CLEAR until a more up-to-date in force file could be generated. That would represent a fairly significant undertaking for Facility Association and its servicing carriers, but my knowledge, limited as it may be of systems development problems, I suspect that will pale in comparison to the major expense of implementing a phasing in mechanism for CLEAR, so if, given a choice between proving it, that there's not going to be major dislocation or coping with it just in case, I suspect that the popular vote amongst the servicing carriers would be we'll suffer through one more time of providing dislocation policy in force files so that we can demonstrate that there's still that consistency. Now, neither of those options is very attractive. Personally, I think ...

MR. O'FLAHERTY: No, I can understand that.

MR. PELLY: ... they're both expensive options.

MR. O'FLAHERTY: Yeah.

MR. PELLY: The position taken by regulators in other jurisdictions that have previously approved CLEAR has been predicated on a belief that dislocation for a residual market mechanism like Facility Association is not as sensitive an issue as it is in the voluntary market. Part of the reason for that is that there is more turn over in Facility Association and that people don't really look to be in Facility Association as their long-term home for insurance, and in fact that's true, so not everybody who's in the in force file in fact will experience whatever dislocation you measure because they're not going to renew in Facility Association. That nasty conviction is going to drop off their record and they're going to get coverage in the voluntary market. Secondly, policyholders are in the residual market for a reason. I can't tell you what the reasons all are because it depends upon the behaviour of the voluntary market, but to the extent that they are there, they are there for reasons that make them unattractive in the voluntary market. They are the riskier portion as perceived by the industry of the voluntary market, well, of the industry, I guess I should say. The consequence of that is that the regulators, it is a very small segment of the industry typically and regulators in our experience have been less concerned with the dislocation issues in that small segment when it is being done very late in the day, very late in the overall industry's process of implementing CLEAR. There really are very few alternatives left because so many companies are already on CLEAR and if Facility Association proceeds with implementation and you have a policyholder who might move from a current premium to a proposed premium that's going to be dislocated by virtue of moving to CLEAR, they're also going to get dislocated if they were in the, moving back to the voluntary market because so much of the voluntary market is on CLEAR now. It's a cost versus benefit issue and the costs are significant. Servicing carriers are being stretched now meeting many of the demands that are being placed on them and it's a serious issue to impose, I like that word now, impose ...

MR. O'FLAHERTY: Yes, I noticed that.

MR. PELLY: ... such a considerable requirement when they've gone through it once with best efforts and, yes, it's taken a while to get it to this Board, but I believe it is intuitive that it's a reasonably stable statistic and severe dislocation is not expected. We saw this same distribution in every jurisdiction that FA did at the December 2000 in force. This isn't a fluke in Newfoundland. This is the way it was in every jurisdiction. I have no reason to believe that the world has changed.

(1:15 p.m.)

MR. O'FLAHERTY: Now, when I was listening to your evidence I was getting the impression that you were suggesting that regulators have a different view of persons who populate the residual market than persons who are in the voluntary market.

MR. PELLY: I think that's true.

MR. O'FLAHERTY: And I was also getting the impression that you were saying that their view of persons in the residual market is that they are, to a certain extent at least, authors of their own misfortune.

MR. PELLY: To a certain extent.

MR. O'FLAHERTY: Isn't it also true though that the percentage of persons entering in the Facility Association market, and I'm perhaps getting a bit far afield from what we're talking about, but just to focus in on that issue, the new entrants into the residual market are tending to be persons with no adverse driving record whatsoever?

MR. PELLY: There are people in Facility Association who aren't there because of their accident and claims, and conviction record, that's true.

MR. O'FLAHERTY: So those persons then are being negatively affected by a perception that's really directed at what I would call high risk drivers rather than high risk premiums, for example.

MR. PELLY: But I think that depends upon why they've been placed in Facility Association.

MR. O'FLAHERTY: Okay. I understand that there was evidence presented before the Nova Scotia Board that something over 60 percent of new entrants into their Facility Association market were actually persons with no accidents and no convictions.

MR. PELLY: I recall something in that order of magnitude, yes.

MR. O'FLAHERTY: So I guess my point is that to a certain extent to tar those persons with a negative perception about high risk drivers is not really apt, is it?

MR. PELLY: That depends again on the reasons why they're placed in the residual market. It's not just accident conviction record. I mean, an example would be muscle cars, if that's an accepted phrase, high power, power to weight ratio cars. They're very popular where I live, I don't know about around here, but that's an example of a vehicle that's just asking to get into an accident, particularly if it's driven by a youthful operator. Are they the authors of their own misfortune? I guess they are. They made a choice to buy that vehicle and if they'd done their research beforehand, they would have found out it's going to be pretty pricey to get it insured too. These are personal decisions ...

MR. O'FLAHERTY: Sure.

MR. PELLY: ... and I think you have to accept the consequences.

MR. O'FLAHERTY: I think we're getting a little bit far afield into the area of the residual, how the actual residual market is created, which is more an issue for the other witnesses that the Board has requested, so I won't pursue that any further. I just conclude on the issue of CLEAR by saying that, you know, if we're asking the Board to implement caps or phase ins, because of the issues of uncertainty that arise from the in force file that was used and the differences with respect to or uncertainties with respect to the fleet, your evidence, as I understand it, is that FA would prefer to have the whole matter deferred to a different application rather than have that implemented.

MR. PELLY: Well, I'm not authorized to offer that as Facility Association's point of view.

MR. O'FLAHERTY: That's not problem then. I don't want to ... that was just your sense of how it would play out.

MR. PELLY: That would be ... if they asked me for my suggestion, if they were given a choice and they say which of these two choices should we pick and they asked me for my opinion, I would give them what I said in my evidence. I mean, obviously it's not my decision and if I had counsel to provide to this Board in making a decision and rendering a decision on this application, and if they felt that they could not get comfortable with the basis as presented in this application, I think there are alternatives open to them other than requiring the creation of a phasing in implementation scheme. The systems development costs of doing that for Newfoundland and Labrador, I hesitate to think of the costs. I'm not a systems expert, I have no idea. It's scary.

MR. O'FLAHERTY: But your expectation is that that would be the case.

MR. PELLY: That would be my expectation.

MR. O'FLAHERTY: Okay. Mr. Chairman, I was going to head into another area and I notice there's only about five minutes left. I hadn't meant to go as long as I did. It's going to take longer than five minutes to get through this. Maybe we can just break at this point and conclude when Mr. Pelly returns.

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes, I think that would be a good idea. Mr. Pelly will be returning, I would assume, on Tuesday.

MR. PELLY: That sounds like a plan, sir.

MR. SAUNDERS, PRESIDING CHAIRMAN: Before we do break though I wanted to just check with counsel on next week's arrangements. Are we okay on that, Ms. Newman?

MS. NEWMAN: Yes. Everyone will recall that we had scheduled Tuesday morning at 9 a.m. for the start of the public participation. The Board is endeavouring to try to rearrange those and I understand that we've had some success with that, although everybody is not confirmed. Rather than breaking up the actuarial evidence it was felt that it would be better to put those matters off till a later point in time and I guess we can address that as that, as this proceeds next week. I understand that counsel are in agreement with that. I believe that everybody has set aside their schedules for the balance of next week as we anticipate that it will last that long and that the experts are available to proceed throughout that period starting on Tuesday at nine.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. And just one other point about next week and that is that there is another matter that another panel of the Board are dealing with on Thursday.

MS. NEWMAN: Yes.

MR. SAUNDERS, PRESIDING CHAIRMAN: And that may interrupt or interfere with our schedule to some degree.

MS. NEWMAN: We may have to finish a little early on Thursday. That hasn't yet been sorted out.

MR. SAUNDERS, PRESIDING CHAIRMAN: And that means we may have to finish an hour earlier or something on Thursday but we'll know that a little later on, I guess. Okay. Any other matters before we break for the weekend?

MR. O'FLAHERTY: I do have one question, Mr. Chairman. I was speaking when I should have been listening to my friend. The schedule on Tuesday, will that commence again with Mr. Pelly, I assume?

MR. SAUNDERS, PRESIDING CHAIRMAN: Yes.

MR. O'FLAHERTY: And then following that what's the next order of business?

MS. NEWMAN: We did, as I said, we're endeavouring to rearrange the public presentations. They were scheduled for 9 a.m. I think two of the three have confirmed that that's fine but one has not yet, so to the extent that they feel it's absolutely necessary to be here at 9 a.m. to present, we may allow that interruption given that we had given that indication, but we are still working on allowing a later time for that so that we can continue with Mr. Pelly, but I anticipate it would only be one public presentation, if they feel it's absolutely necessary.

MR. O'FLAHERTY: Thank you very much.

MR. SAUNDERS, PRESIDING CHAIRMAN: Okay. Okay, thank you. Thank you, Mr. Pelly.

MR. PELLY: Thank you.

MR. SAUNDERS, PRESIDING CHAIRMAN: Have a good weekend.

(hearing adjourned)