

ANNUAL REPORT

OF THE

BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

ON THE OPERATIONS CARRIED OUT UNDER

THE AUTOMOBILE INSURANCE ACT

Chapter A-22, R.S.N. 1990, AS AMENDED

FOR THE PERIOD APRIL 1, 2001 TO MARCH 31, 2002

Executive Summary

This report highlights the main activities of the Board in carrying out its mandate under the Automobile Insurance Act. Although the Board did not adopt new benchmarks during the year, it none-the-less had a very active year issuing seventy-seven orders in 2001-2002 compared with thirty-six in the previous reporting year.

Due to increased activity in dealing with rate applications from insurers, activity in the area of compliance audits was reduced.

In April 2001, the Board awarded a five-year contract to MMC Enterprise Risk Consulting Limited of Toronto to provide actuarial consulting services to the Board. The company was selected from a number of respondents to a Request for Proposals issued by the Board.

The Board notes that the industry loss experience reported in 2001 shows serious deterioration in claims for the first time in five years. The 2000 preliminary loss ratio reported for Territory 1 is 121%, up from 94% in 1999. Overall, on a province-wide basis in 2000, claims increased 24.7% over 1999 levels, while premiums increased by 4.6%. When compared to 1998 levels, claims increased by 26.2% while premiums increased 3.8%.

The Board anticipates that these loss ratios will put upward pressure on rates in the short term, a fact evidenced in recent rate filings by insurers. The Board will soon be undertaking a benchmark analysis based on 2001 industry loss experience and may hold a hearing on the setting of Benchmark rates in the coming fall.

During the year, staff of the Board were involved in the Automobile Insurance Reform initiative proposed by the Minister of Government Services and Lands. Staff involvement was in connection with attending meetings and participation at the Minister's Town Hall meeting held in St. John's on March 12, 2002.

The Board also approved a reduced private passenger and a miscellaneous classes rate filing by the residual market insurer, Facility Association.

AUTOMOBILE INSURANCE DIVISION

GENERAL

The Automobile Insurance Act, Chapter A-22, of the Revised Statutes of Newfoundland, 1990, charges the Board with specific statutory responsibilities concerning the regulation of automobile insurance rates in the Province of Newfoundland and Labrador.

Section 48 states:

"The Board has the general supervision of the rates an insurer charges or proposes to charge for automobile insurance."

Sections 49 to 53 delineate specific filing requirements to be adhered to by insurers.

Sections 54 to 59 outline administrative procedures of the Board and allow for the applicability of the Public Utilities Act for the purposes of this Act.

Section 60 authorizes the implementation of regulations.

During the year under review the Board continued to discharge its regulatory responsibilities to ensure that rates are fair for consumers, commensurate with the risk represented and insured by companies, and adequate to cover future claims obligations and operating costs of automobile insurance companies.

A key element of this effort is the establishment of Benchmark Rate Ranges which are based upon a study conducted by an independent actuarial consulting firm retained by the Board. This study takes into consideration the automobile insurance industry loss cost data for Newfoundland and Labrador provided by the rating program of the Insurers' Advisory

Organization (IAO) and the Automobile Insurance (Claims) Experience Report of the Insurance Information Centre of Canada (IICC).

The IAO and IICC are industry organizations which gather statistical data relative to the industry experience. The data are used to develop adequate and reasonable rates, sufficient for insurers to meet potential future claims obligations and to recover operating costs.

ACTUARIAL CONSULTANTS

In April 2001, the Board awarded a five-year contract for Actuarial Consulting services to MMC Enterprise Risk Consulting Limited of Toronto, Canada. The contract was awarded after a thorough review and interview of selected firms responding to the Board's January Request for Proposals.

AUTOMOBILE INSURANCE REFORM

During 2001-2002, the Board was an active participant in the process initiated by the Department of Government Services and Lands in connection with the Minister's Proposals for Automobile Insurance Reform consultation paper. The Board reported to the Department with its views and comments of the Minister's proposed reforms. In addition, senior staff of the Board attended meetings between the Minister and his officials with the insurance industry representatives and representatives of the legal community and as a member of the panel at the Minister's Town Hall meeting held in St. John's on March 12, 2002.

BENCHMARK SYSTEM

The Board utilizes the Benchmark Rate Ranges in reviewing annual insurance rate filings of individual insurers. Rate filings which fall above or below the Benchmark Rate Ranges are

approved only when adequately supported with actuarial justification by the Applicant and after thorough review by the Board, its staff, and if deemed necessary, its consulting actuaries.

The main purposes of the Benchmark system are:

1. To expedite the review of rate filings by providing a streamlined approval process whereby automatic approval is given rate filings where the adjusted base rates and the differentials fall within the Benchmark Rate Ranges.
2. To foster knowledgeable competition among the companies by providing a range of base rates which are the result of an actuarial analysis of the industry wide claims experience in the Province of Newfoundland and Labrador.
3. To ensure that rates charged policyholders are reflective of industry loss experience and that insurers are receiving premiums commensurate with the risks underwritten and which will meet their future claims obligations and recover their operating expenses.

RATING TERRITORIES

The Province of Newfoundland and Labrador is subdivided into three territories for rating purposes. These territories are established and defined in the Automobile Insurance Statistical Plan approved for use by the Superintendent of Insurance. The rating territory definitions for the Province of Newfoundland and Labrador as revised by the Superintendent of Insurance on April 4, 1997 are:

1. Territory 1,
Avalon District, Statistical Plan Code 004
Consisting of the City of St. John's, including that part of the island east of

Highway 202, being a line between the communities of Old Shop and Chapel Arm in Trinity Bay to the North, and Long Harbour and Ship Harbour in Placentia Bay to the South.

2. Territory 2,
Bonavista and Burin District, Statistical Plan Code 005
Consisting of that territory east of a line drawn from Port Blandford in Bonavista Bay to English Harbour East in Fortune Bay, excluding the Avalon District.

Remainder of the province, Statistical Plan Code 007
Consisting of those parts of the Province of Newfoundland and Labrador, excluding the Avalon, Labrador, and the Bonavista and Burin District.

3. Territory 3, Labrador District, Statistical Plan Code 006
The entire District of Labrador.

RATES

During 2001-2002, the Board continued its policy of requiring insurers to file automobile insurance rates within the Benchmark Rate Ranges, unless a company could actuarially justify, based on its own experience in the Province, rates outside the Benchmarks. This policy is designed to ensure that insurers' rates are reflective of current industry trends in loss costs and loss experience.

During the previous reporting period, the Board received fifteen rate filings by automobile insurers indicating rates for some coverages below the Benchmark minimums, to take effect during 2000-2001. By comparison, during the current reporting period, the Board received twelve applications from automobile insurers seeking approval of certain rates below the Benchmark minimums. Each filing is required to be supported by an actuarial analysis by the company of its

own experience in the Province of Newfoundland and Labrador. As at the end of this reporting period, of the twelve applications received, all have been approved as presented or modified with rates for certain coverages below the Benchmark minimums. In the majority of cases, these non-Benchmark filings represented a move by insurers to bring rates closer to the bottom of the Benchmarks, and thus represent an increase in rates previously approved.

LOSS RATIOS

During 2001-2002, the Board's actuarial consultants undertook a Benchmark analysis of the reported industry loss experience in order to establish Benchmark Rate Ranges for use with filings taking effect in 2002. After reviewing the Consultants' Report, the Board decided to allow its 2001 Benchmarks to continue in use for 2002. As a result, there were no new Filing Instructions issued to industry during the period.

The actuarial model used by the Board in determining its 2001 Benchmark Rate Ranges established a reference point for loss costs in relation to premiums. Based upon the determination that commissions and administrative expenses averaged 26.2% of each premium dollar written by the industry as a whole, and allowing a negative underwriting profit margin of 1.8% to take into account investment income earned on premiums invested by the industry, the Board's Benchmark Base Rate for Third Party Liability provides sufficient resources for the industry to sustain an average loss ratio of 75.6%.

As a point of reference, for Public Liability and Property Damage, the annual loss ratio was 104% in 1987. During the period 1988 – 1992, however, province-wide loss costs were especially severe with loss ratios of 120%, 133%, 140%, 127%, and 135%, respectively. The loss ratio has declined in 1993 and subsequent years. For the first time in five years, the preliminary loss ratio for liability in a current year has risen above 100%. For 2000, the preliminary figure is 115%. By comparison, the preliminary 1999 loss ratio was 91%. Recent loss ratio figures will,

however, fluctuate as the claims experience for each year matures with time. These figures may either improve or deteriorate, depending on how the industry's claims experience matures.

| TABLE 1 IBC LOSS RATIOS, THIRD PARTY LIABILITY Private Passenger Automobile Province of Newfoundland and Labrador All Rating Territories | | | | | | | |
|--|-----------------|-----------------|-----------------|------------------|-----------------|-----------------|-----------------|
| Accident Year | 1994 IBC Report | 1995 IBC Report | 1996 IBC Report | 1997 ICC* Report | 1998 ICC Report | 1999 ICC Report | 2000 ICC Report |
| 1989 | - | - | - | - | - | - | - |
| 1990 | 140% | - | - | - | - | - | - |
| 1991 | 123 | 127% | - | - | - | - | - |
| 1992 | 130 | 133 | 135% | - | - | - | - |
| 1993 | 116 | 114 | 112 | 113% | - | - | - |
| 1994 | 104 | 111 | 102 | 99 | 99% | - | - |
| 1995 | - | 100 | 97 | 83 | 85 | 84% | - |
| 1996 | - | - | 80 | 75 | 75 | 76 | 75% |
| 1997 | - | - | - | 82 | 75 | 74 | 75 |
| 1998 | - | - | - | - | 82 | 82 | 82 |
| 1999 | - | - | - | - | - | 91 | 100 |
| 2000 | - | - | - | - | - | - | 115 |

* In 1998, the Insurance Bureau of Canada and the Vehicle Information Centre of Canada merged to form the Insurance Information Centre of Canada.

The figures shown in the Tables 1 to 3 provide a clear indication as to how loss ratios for a given year can fluctuate in subsequent years. For example, in Table 1 for accident year 1994, IBC estimated in its 1994 report that the anticipated ultimate loss ratio for the year would be 104%. However, in 1995, the IBC revised its estimate for accident year 1994 to

111%, based on data which were one year matured. The figure was further revised in 1996 and 1997, and for 1998 the figure stood at 99%. Changes to the loss ratio results from maturity of the industry's claims experience. This figure may continue to change as the data move to full maturity. More recently, since 1993, province-wide loss data appear to have stabilized and subsequent years' development has not shown serious deterioration. Indications are that this stability is evident in 1994 and subsequent years' loss experience by industry; however, the trend appears to have deteriorated significantly with 2000 results.

| TABLE 2 IBC LOSS RATIOS, THIRD PARTY LIABILITY Private Passenger Automobile Province of Newfoundland and Labrador Rating Territory 1 | | | | | | | |
|--|-----------------|-----------------|-----------------|------------------|-----------------|-----------------|-----------------|
| Accident Year | 1994 IBC Report | 1995 IBC Report | 1996 IBC Report | 1997 ICC* Report | 1998 ICC Report | 1999 ICC Report | 2000 ICC Report |
| 1989 | - | - | - | - | - | - | - |
| 1990 | 164% | - | - | - | - | - | - |
| 1991 | 143 | 149% | - | - | - | - | - |
| 1992 | 155 | 160 | 164% | - | - | - | - |
| 1993 | 137 | 137 | 135 | 134% | - | - | - |
| 1994 | 115 | 121 | 114 | 112 | 115% | - | - |
| 1995 | - | 106 | 107 | 92 | 96 | 96% | - |
| 1996 | - | - | 81 | 78 | 80 | 81 | 81% |
| 1997 | - | - | - | 85 | 77 | 77 | 78 |
| 1998 | - | - | - | - | 82 | 84 | 85 |
| 1999 | - | - | - | - | - | 94 | 103 |
| 2000 | - | - | - | - | - | - | 121 |

* In 1998, the Insurance Bureau of Canada and the Vehicle Information Centre of Canada merged to form the Insurance Information Centre of Canada.

The reason the loss ratios change is due, in part, to the long tail effect evident in Third Party claims. That is, the time interval between the making of a claim and its ultimate settlement. Small claims for property damage are usually settled quickly, however, where there is a matter in dispute, or there is bodily injury, claims may take years to settle, most probably through court action. As a result, a claim made in 1998 may not be settled until 2002 or later and may cost the insurer more to settle than originally anticipated when the 1998 loss reserves were established and the loss ratio calculated. The more recent trends, 1994 up to 1998, may be interpreted to show that claims have been settling at or near the amounts originally reserved. The reasons for this are not clear but may result from better claim-reserving practices of insurers, less litigious claimants, a combination of both, or other reasons not identified.

The serious deterioration in loss experience, commencing in 1999 and evidenced in the preliminary loss estimate of 115% for 2000, is the basis on which insurers have made recent rate filings increasing automobile insurance premiums. For Territory 1, the rating territory having the highest vehicle population in the Province historically, loss experience was especially severe for the period 1988 to 1993. This was followed by significant increases in rates in 1993, 1994 and 1995.

Table 2 contains the loss ratio, by year, for Public Liability and Property Damage for rating Territory 1 only. It appears that losses in Territory 1 are again on the rise to levels not seen since 1994/95. Rates are already on the increase based on filings made by insurers. Over the past year, the Board has seen significant increases in Third Party Liability and Accident Benefits rates of some insurers.

For comparative purposes, Table 3 contains the loss ratio for Public Liability and Property Damage for rating Territory 2 only.

| TABLE 3 | | | | | | | |
|---|------------------------|------------------------|------------------------|-------------------|-------------------------|-------------------------|-------------------------|
| IBC LOSS RATIOS, THIRD PARTY LIABILITY | | | | | | | |
| Private Passenger Automobile Province of Newfoundland and Labrador Rating Territory 2 | | | | | | | |
| Accident Year | 1994 IBC Report | 1995 IBC Report | 1996 IBC Report | 1997 IICC* | 1998 IICC Report | 1999 IICC Report | 2000 IICC Report |
| 1989 | - | - | - | - | - | - | - |
| 1990 | 100% | - | - | - | - | - | - |
| 1991 | 89 | 90% | - | - | - | - | - |
| 1992 | 94 | 94 | 92% | - | - | - | - |
| 1993 | 82 | 78 | 75 | 80% | - | - | - |
| 1994 | 89 | 101 | 87 | 81 | 75% | - | - |
| 1995 | - | 91 | 77 | 67 | 64 | 62% | - |
| 1996 | - | - | 77 | 69 | 66 | 68 | 66% |
| 1997 | - | - | - | 76 | 72 | 70 | 69 |
| 1998 | - | - | - | - | 78 | 76 | 76 |
| 1999 | - | - | - | - | - | 82 | 92 |
| 2000 | - | - | - | - | - | - | 103 |

* In 1998, the Insurance Bureau of Canada and the Vehicle Information Centre of Canada merged to form the Insurance Information Centre of Canada.

As can be seen from Table 1, with the exception of the period 1996-1999, the initial overall loss-ratio estimate for the Province in total has consistently exceeded 100%. This is a direct result of the excessive losses experienced in Territory 1, as indicated in Table 2. Lower loss ratios for Territory 2 (Table 3) and Territory 3 (not shown) serve to reduce the effects of the

Territory 1 losses, yielding the province-wide loss ratios contained in Table 1. Rates for each Territory, however, are based on the territorial experience and not on the overall provincial experience. Hence, it can be easily seen from the results shown in Table 2 why liability rates in the Territory 1 region increased dramatically during the period 1993 – 1996 and are commencing another upward swing. Preliminary results in Territory 1 for 2000 indicate that losses appear to have destabilized in the past two years.

Of particular note is the fact that for the first time in the past nine years, the preliminary loss ratio for Territory 2 exceeds 100%.

2002 BENCHMARKS

During the fall of 2001, the Board reviewed new private passenger and commercial benchmarks prepared by its Actuarial Consultants, MMC Enterprise Risk Consulting Limited. Despite these Benchmarks indicating a modest reduction in rates, the Board decided not to implement same and to allow the 2001 Benchmarks to continue. The Board's decision was made in part due to certain changes in methodology utilized by the consultant, and the fact that the data did not include the particularly harsh winter of the past year. It was determined that the changes in methodology formed the main reason for a modest decline. As the reduction obtained was a one-time savings only, it was determined that the new benchmarks were not indicative of a trend in reduction. In announcing its decision, the Board advised that it may elect to convene a public hearing on the Benchmarks in 2002.

FACILITY ASSOCIATION

Board Order No. A. I. 36 (2000-2001) in connection with the Board's review of the surpluses in Revenues over Expenses reported in the Financial Statements of the Facility Association was released March 30, 2001. In May 2001, Facility Association filed for a revised schedule of private passenger and miscellaneous classes automobile insurance rates. In its filing,

Facility Association proposed an overall average rate increase of +13.2% for private passenger, +7.7% for snow vehicles and +16.1% for motorcycles and ATV's.

Following a review by the Board's Actuarial Consultant, and on the basis of their report and advice of staff, the Board approved of the snow vehicle and miscellaneous classes rate increase as requested. With respect to the private passenger rates, the Board accepted its Actuarial Consultants' Report and approved a 10% increase. The new rates are set to come into effect May 1, 2002.

COMPLIANCE AUDIT PROGRAM

In April 1994, in order to discharge its regulatory responsibilities more effectively under the *Automobile Insurance Act*, the Board decided that it would be beneficial to implement a compliance audit program of the rates and rating practices of the insurance companies which it regulates.

The audit program was developed in consultation with the accounting firm, Ernst & Young, and was designed to:

- Verify that the automobile insurance premiums charged policy holders were in accordance with the base rates and differentials filed with and approved by the Board.
- Verify that the rates were not discounted or surcharged, other than in accordance with those discounts or surcharges filed with and approved by the Board.
- Review individual company underwriting guidelines for risk selection.

- Determine if the company's underwriting definitions for the various risk selection factors conformed with, or varied from, those contained in the company's underwriting manual or the Automobile Insurance Statistical Plan approved for use by the Superintendent of Insurance.

The results of the compliance audit are used by the Board:

- To obtain a better understanding of the methods under which the industry and individual companies operate so that Commissioners and staff of the Board will be well informed when dealing with consumer enquiries and complaints.
- To identify the areas where the individual company rates, underwriting guidelines and definitions vary from those approved by the Board or contained in the Automobile Insurance Statistical Plan.
- To provide audited companies with a review of the audit findings and, where appropriate, to make recommendations for the corrective actions necessary to ensure that companies comply with their filed rates, underwriting guidelines and definitions.

During the period April 1, 2001 to March 31, 2002, the Board completed three compliance audits of automobile insurers operating in the Province. The compliance audits completed during 2001-2002 involved two national insurers, and the Facility Association.

Of the audits completed, one highlighted areas of concern that required further action by the Board. In all audits there were minor areas of concern identified, resulting in recommendations for corrective action to be taken by the insurer.

Given the findings of the audits, there appears to be compliance by insurers with the legislation. The majority of errors uncovered by the Board's audits appear clerical in nature. The incidence of overt actions by insurers to circumvent the legislation as it relates to rates is not an issue at this time.

The Board intends to continue the compliance audit program and feels that it is beneficial to all participants in the automobile insurance industry. Insurance companies have a heightened awareness of the Board's regulatory roles, responsibilities and functions. Policyholders will benefit from uniform treatment in rates and rating practices of companies for risks exhibiting similar characteristics. The Superintendent of Insurance is made aware of ongoing audits and is advised immediately of any matter of concern coming to the attention of the Board's compliance auditor which comes within the regulatory mandate of the Superintendent.

The Board continues to enjoy a cooperative working relationship with the Office of the Superintendent of Insurance and during the year continued to discuss with representatives of that office matters of mutual ongoing concern. The Superintendent of Insurance is provided with copies of all Board Orders issued in connection with automobile insurers, as well as copies of all audit reports.

MARKETPLACE CHANGES

At the beginning of 2001-2002, there were fifty-eight automobile insurers operating in the province of Newfoundland and Labrador. The distribution of these companies by size and market share is contained in Table 4.

| TABLE 4 | | | |
|---|----------------------------|--------------------------------|--------------------------------|
| DISTRIBUTION OF COMPANIES BY SIZE AND MARKET SHARE | | | |
| 000s omitted | | | |
| Direct Premiums Written | Number of Companies | Percent of Market Share | Direct Premiums Written |
| \$ 0 – \$ 500 | 31 | 1.28 | 2,365 |
| 501 – 1,000 | 4 | 1.76 | 3,258 |
| 1,001 – 5,000 | 13 | 17.59 | 32,566 |
| Over 5,000 | 10 | 79.37 | 146,931 |
| Totals | 58 | 100.00 | 185,120 |

The volume of automobile insurance written in the province showed a modest increase of 4.6% during 2000 while claims showed a sharp increase at 24.7%. Direct premiums written information for the current reporting period will not be available in an aggregated format until mid 2002. Information obtained from the Office of the Superintendent of Insurance on the total automobile insurance market written in the province during 2000 is contained in the following table:

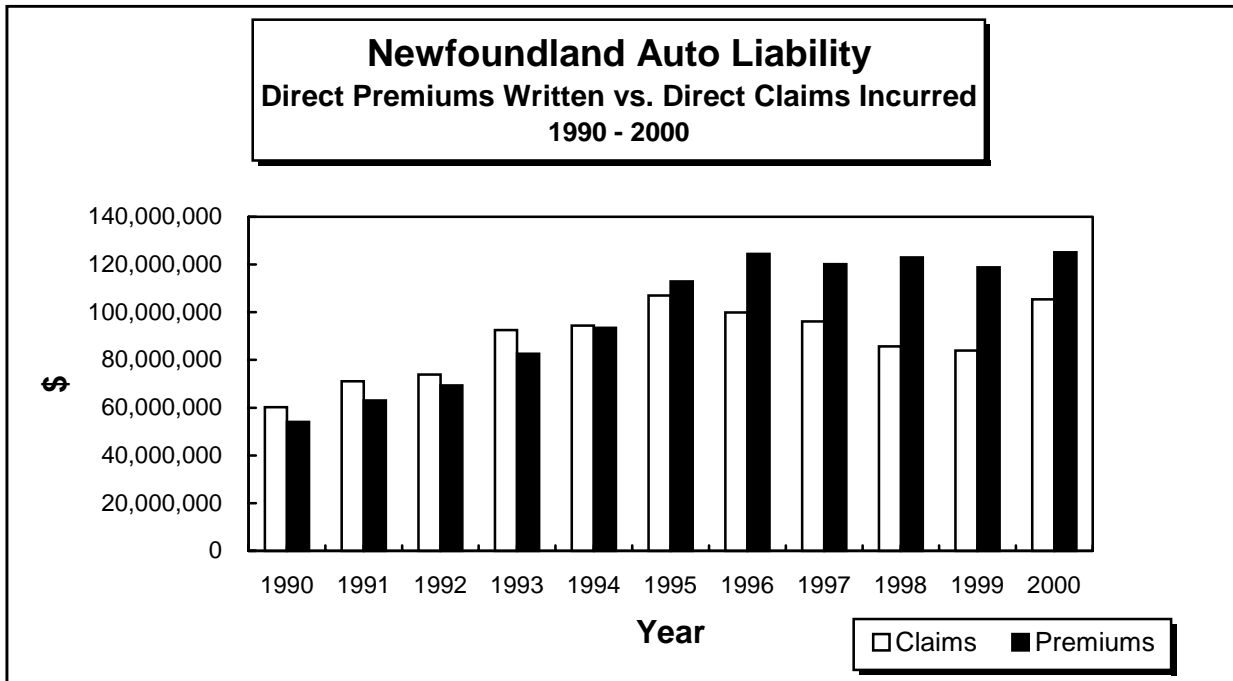
| TABLE 5 | | | | |
|-----------------------------|-------------|-------------|------------------|-----------------|
| MARKET VOLUME | | | | |
| AUTOMOBILE INSURANCE | | | | |
| 000s omitted | | | | |
| | 2000 | 1999 | \$ change | % change |
| DPW | 185,120 | 176,913 | 8,207 | 4.6% |
| DCI | 148,694 | 119,244 | 29,450 | 24.7% |

Table 6 contains a two-year comparative review of the automobile-insurance market breaking the information down into direct premiums written (DPW) and direct claims incurred (DCI) by the three major premium classifications.

**TABLE 6
MARKET VOLUME BY CLASS
AUTOMOBILE INSURANCE
000s omitted**

| | 2000 | 1999 | \$ change | % change |
|----------------------------------|---------|---------|-----------|----------|
| Third Party Liability DPW | 125,080 | 118,840 | 6,240 | 5.25% |
| Third Party Liability DCI | 105,434 | 83,956 | 21,478 | 25.58% |
| Personal Accident DPW | 12,156 | 12,784 | - 628 | - 4.91% |
| Personal Accident DCI | 10,137 | 8,307 | 1,830 | 22.02% |
| Other DPW | 47,884 | 45,289 | 2,595 | 5.73% |
| Other DCI | 33,123 | 26,981 | 6,142 | 22.76% |

The following graph indicates the changes in province-wide Third-Party-Liability direct premiums and direct claims, by year, for the last eleven years.



It should be noted that Direct Claims Incurred do not include the overhead and operation expenses of the company. These expenses, for purposes of the 2001 benchmarks, have been determined to be 26.2% of premium.

COMPLAINTS

During the year the Board received a limited number of complaints and enquiries. These complaints and enquiries were generally in relation to rating practices of insurers and/or agents. All complaints and enquiries were addressed by staff.

RATE APPLICATIONS

During 2001-2002, the Board issued seventy-seven Orders under authority of the *Automobile Insurance Act*. These Orders resulted from: -

- (i) Sixty-two (62) applications to amend rates for Private Passenger, Commercial, Miscellaneous, Motor Cycle, Snow Vehicle, Trailer, and Camper Coach classes of business.
- (ii) One (1) order approving or varying discounts applicable to Private-Passenger rating programs.
- (iii) Five (5) orders issued varying previous orders issued during the year to revise the implementation dates of the rates approved.
- (iv) One (1) order issued on the review of the rates charged on business placed in the Facility Association.
- (v) Eight (8) orders issued on setting rates for insurers.

ASSESSMENT

The operating costs of the Board's Insurance Division for the 2001-02 year were estimated at \$563,650.00. These costs were assessed against insurers with the approval of the Minister, pursuant to Section 59 of the *Automobile Insurance Act*, at a rate of 3.0 mils or the equivalent of 0.3% of Direct Premiums Written by the market.