

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, 2002 TO MARCH 31, 2003

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 nonetheless had an active year issuing thirty-nine orders in 2002-2003.

Due to increased activity in dealing with rate applications from insurers, as well as other operational and regulatory activities of the Board, activity in the area of compliance audits was reduced.

The Board notes that the industry loss experience reported in 2001 shows serious deterioration in claims for the second time in five years. The 2001 preliminary loss ratio reported for Territory 1 is 116%. Overall, on a province-wide basis in 2001, claims increased 43.7% over 2000 levels, while premiums increased by 6.1%.

The Board anticipates that these loss ratios will continue to 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 2002 industry loss experience.

During the year, staff of the Board continued to be involved in the Automobile Insurance Reform initiative proposed by the Minister of Government Services and Lands. Staff involvement was in connection with providing comment on draft proposed legislative changes to the Insurance Companies Act and the Automobile Insurance Act.

The Board also held a hearing on revised private passenger and commercial class rates filed 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

Actuarial Consulting services are provided to the Board by Mercer Risk Financing and Consulting, a firm based in Toronto.

AUTOMOBILE INSURANCE REFORM

During 2002-2003, the Board continued as 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 has responded to the Department with its views and comments on legislative changes designed to bring about Government's reform initiatives.

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 2002-2003, 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 twelve rate filings by automobile insurers indicating rates for some coverages below the Benchmark minimums, to take effect during 2001-2002. By comparison, during the current reporting period, the Board received eight 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 eight 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.

For the remaining companies, the Board has seen a marked shift in rate position. Whereas in prior years, most companies filed rates at or near the bottom of the Benchmarks, this year these companies filed rates at levels between the midpoint and upper end of the Benchmarks. As well, for the first time, the Board has approved rates for a regular-market insurer above the upper limit.

These activities were observed, notwithstanding the fact that the Board's Benchmarks have remained unchanged for the past three years.

LOSS RATIOS

During the year, 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 2003. After reviewing the Consultants' Report, the Board decided to allow its 2001 Benchmarks to continue in use for 2003. 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 2001, the preliminary figure is 97%. By comparison, the preliminary 2000 loss ratio was 115%. 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	1995 IBC Report	1996 IBC Report	1997 IICC* Report	1998 IICC Report	1999 IICC Report	2000 IICC Report	2001 IICC Report
1991	127%	-	-	-	-	-	-
1992	133	135%	-	-	-	-	-
1993	114	112	113%	-	-	-	-
1994	111	102	99	99%	-	-	-
1995	100	97	83	85	84%	-	-
1996	-	80	75	75	76	75%	-
1997	-	-	82	75	74	75	75%
1998	-	-	-	82	82	82	81
1999	-	-	-	-	91	100	99
2000	-	-	-	-	-	115	113
2001	-	-	-	-	-	-	97

* 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 1995, IBC estimated in its 1995 report that the anticipated ultimate loss ratio for the year

would be 100%. However, in 1996, the IBC revised its estimate for accident year 1995 to 97%, based on data which were one year matured. The figure was further revised in 1997 and 1998, and for 1999 the figure stood at 84%. 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 somewhat with 2001 results.

TABLE 2 IBC LOSS RATIOS, THIRD PARTY LIABILITY Private Passenger Automobile Province of Newfoundland and Labrador Rating Territory 1							
Accident Year	1995 IBC Report	1996 IBC Report	1997 IICC* Report	1998 IICC Report	1999 IICC Report	2000 IICC Report	2001 IICC Report
1991	149%	-	-	-	-	-	-
1992	160	164%	-	-	-	-	-
1993	137	135	134%	-	-	-	-
1994	121	114	112	115%	-	-	-
1995	106	107	92	96	96%	-	-
1996	-	81	78	80	81	81%	-
1997	-	-	85	77	77	78	79%
1998	-	-	-	82	84	85	84
1999	-	-	-	-	94	103	102
2000	-	-	-	-	-	121	120
2001	-	-	-	-	-	-	116

* 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 trends, 1996 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 deterioration in loss experience, commencing in 1999 and evidenced in the preliminary loss estimate of 115% for 2000, and 97% for 2001, may be 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	1995 IBC Report	1996 IBC Report	1997 IICC* Report	1998 IICC Report	1999 IICC Report	2000 IICC Report	2001 IICC Report
1991	90%	-	-	-	-	-	-
1992	94	92%	-	-	-	-	-
1993	78	75	80%	-	-	-	-
1994	101	87	81	75%	-	-	-
1995	91	77	67	64	62%	-	-
1996	-	77	69	66	68	66%	-
1997	-	-	76	72	70	69	70%
1998	-	-	-	78	76	76	73
1999	-	-	-	-	82	92	92
2000	-	-	-	-	-	103	99
2001	-	-	-	-	-	-	116

* 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 1995 and 2000, the initial overall loss-ratio estimate for the Province in total has been equal to, or less than, 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 in this and prior reports why liability rates in the Territory 1 region increased dramatically during the

period 1993 – 1996 and are commencing another upward swing after some years of relative stability. Preliminary results in Territory 1 for 2001 indicate that losses appear to have destabilized in the past three years.

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

2003 BENCHMARKS

During the fall of 2002, 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 change 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. It was determined that the changes in methodology formed the main reason for the change. While the Board had previously indicated that it may hold a Benchmark Hearing, it did not do so during 2002-03. The main reasons for this were the fact that there were no changes to Benchmark rate levels, plus pending proposed changes to legislation which would have reduced the Board's rate regulation responsibilities

FACILITY ASSOCIATION

In September 2002, Facility Association filed for a revised schedule of private passenger and commercial classes automobile insurance rates. In its filing, Facility Association proposed an overall average rate increase of +41.3% for private passenger, and +48.% for Commercial Vehicles.

Upon receipt of the filing, the Board commissioned an independent actuarial review and decided that a hearing would be held. The report of the independent consultant was received on

November 26, 2002, and the hearing commenced on December 11, 2002. On November 13, 2002, Government appointed a Consumer Advocate to intervene in the rate filing.

The Facility Association Hearing commenced on December 11, 2002 and spanned twelve hearing days, concluding with Final Argument on February 12, 2003. As at March 31, 2003, the Board has not released its Decision.

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, 2002 to March 31, 2003, the Board did not complete any audits of automobile insurers operating in the Province.

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 2002-2003, there were fifty-six 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	1.74	3,525
501 – 1,000	2	.60	1,207
1,001 – 5,000	11	15.12	30,422
Over 5,000	12	82.54	166,200
Totals	56	100.00	201,354

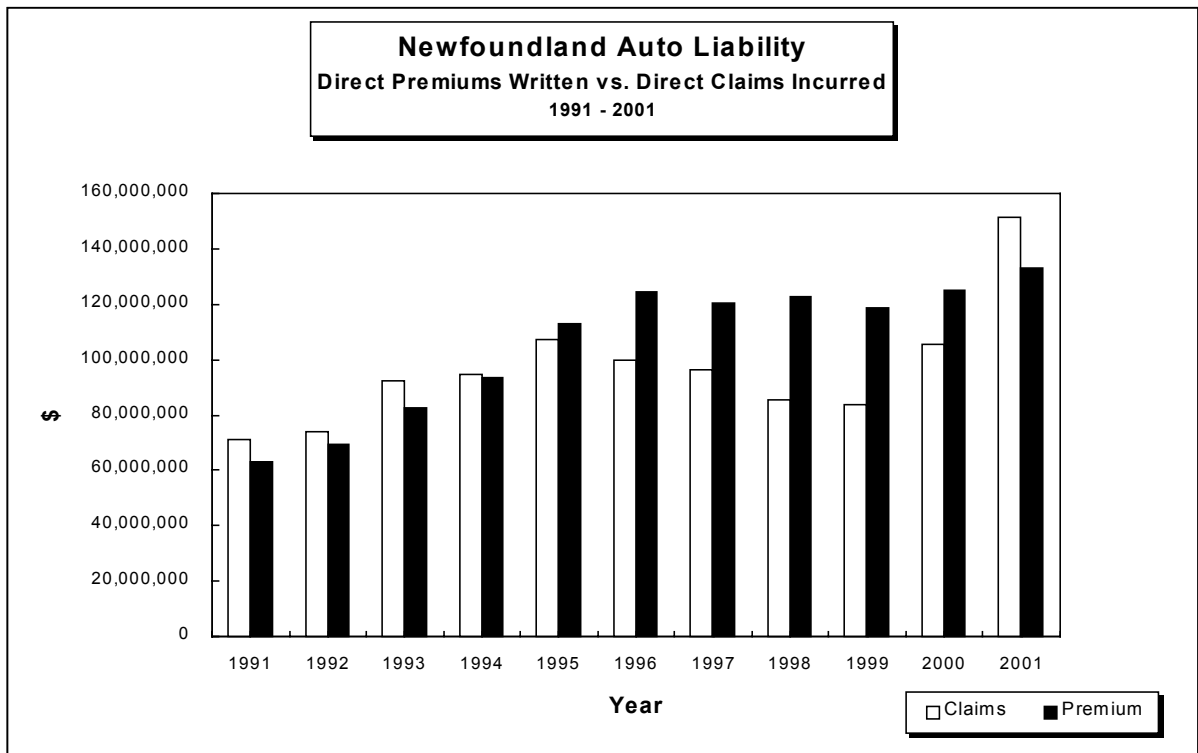
The volume of automobile insurance written in the province showed a modest increase of 8.8% during 2001 while claims showed a sharp increase at 35.3%. Direct premiums written information for the current reporting period will not be available in an aggregated format until mid 2003. Information obtained from the Office of the Superintendent of Insurance on the total automobile insurance market written in the province during 2001 is contained in the following table:

TABLE 5 MARKET VOLUME AUTOMOBILE INSURANCE 000s omitted				
	2001	2000	\$ change	% change
DPW	201,354	185,120	16,234	8.8%
DCI	201,143	148,694	52,449	35.3%

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					
		2001	2000	\$ change	% change
Third Party Liability	DPW	132,763	125,080	7,683	6.1%
Third Party Liability	DCI	151,507	105,434	46,073	43.7%
Personal Accident	DPW	13,164	12,156	1,008	8.3%
Personal Accident	DCI	11,447	10,137	1,310	12.9%
Other	DPW	55,427	47,884	7,543	15.8%
Other	DCI	38,188	33,123	5,065	15.3%

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 2002-2003, the Board issued thirty-nine Orders under authority of the *Automobile Insurance Act*. These Orders resulted from: -

- (i) Thirty-five (35) applications to amend rates for Private Passenger, Commercial, Miscellaneous, Motor Cycle, Snow Vehicle, Trailer, and Camper Coach classes of business.
- (ii) Two (2) orders issued varying previous orders issued during the year to revise the implementation dates of the rates approved.
- (iii) Two (2) procedural orders issued relative to the Facility Association Hearing.

ASSESSMENT

The operating costs of the Board's Insurance Division for the 2002-03 year were estimated at \$487,346.00. 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 2.5 mils or the equivalent of 0.25% of Direct Premiums Written by the market.