



*Newfoundland
& Labrador*

BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

**ANNUAL REPORT
ON OPERATIONS CARRIED OUT UNDER
THE AUTOMOBILE INSURANCE ACT
Chapter A-22, R.S.N.L. 1990, AS AMENDED
FOR THE PERIOD
APRIL 1, 2005 TO MARCH 31, 2006**

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OF THE

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EXECUTIVE SUMMARY

This report highlights the main activities of the Board in carrying out its mandate under the *Automobile Insurance Act*.

In March 2005 Government announced additional reforms in relation to automobile insurance to be effective August 1, 2005. Principal among these were the elimination of age, sex and marital status as rating variables, introduction of a new Class of Use system incorporating years driving experience as a rating factor, a mandated 5% reduction in premiums unless actuarially justified otherwise, a new rate setting process based on individual company filings and permission of group rating.

Following Government's announcement the Board undertook an assessment of the implications these reforms would have on rate reviews and approvals and issued new rate filing instructions for use by industry. These instructions designated filings as being Category 1 representing rate reductions on all rates of a minimum of 5% or Category 2 demonstrating actuarial justification of any filing where rates were not reduced by a minimum of 5%. The Board's instructions set out specific parameters including an ROE/ROI factor, Premium to Surplus Ratio and other trend factors. The Board worked with industry to facilitate a smooth transition once the reforms were proclaimed.

Consistent with the August 1, 2005 reforms, the Board during the year received 21 Category 1 filings reflecting the 5% mandated reduction. In addition, the Board issued 11 orders pertaining to Category 2 filings thus approving specific actuarially justified rates which had not been reduced by the mandated 5%. As the rate reductions were mandated for private passenger insurance only, those insurers operating strictly in the commercial auto area were not required to re-file their rating programs. The Board did, however, issue one order during the year for a single application for revised commercial rates.

Based on the most recently available market information (2004), fifty-four automobile insurers reported direct premiums written of \$266,857,000 in the Province. The market continues to show a high level of concentration with the top 11 insurers writing approximately 85% of all the automobile insurance business.

AUTOMOBILE INSURANCE REGULATION

GENERAL

The Automobile Insurance Act, Chapter A-22, R.S.N.L. 1990, as amended, provides 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 provide for the applicability of the procedural provisions of the *Public Utilities Act*.

Section 60 authorizes the implementation of regulations.

During the year under review Government enacted significant changes with respect to the method of regulation of automobile insurance rates in this Province. As well, additional legislative and regulatory changes expanded the Board's responsibilities for other regulatory functions in relation to the automobile insurance industry beyond the traditional "rate approval" role.

ACTUARIAL CONSULTANTS

Mercer Risk Finance and Insurance Consulting Limited, a firm based in Toronto, provides actuarial consulting services to the Board. These services are provided pursuant to a contract executed under a Request For Proposal (RFP) process. The current contract expires at the end of March 2006. A new RFP was issued and the Board is evaluating a number of proposals from companies interested in providing actuarial consulting services.

AUTOMOBILE INSURANCE REFORM

In August 2005, following consideration of the final report of the Board's review of the automobile insurance industry delivered March 31, 2005, Government enacted legislative and regulatory changes affecting the automobile insurance industry. These changes were in addition to those implemented in August 2004.

The key regulatory changes enacted in August 2005 included:

- i. Elimination of age, sex and marital status from consideration as rating variables.
- ii. Implementation of the use of "years driving experience" as an acceptable rating variable.
- iii. Rate filing requirements for all private passenger insurers on the basis of:
 - a. A 5% reduction in all currently approved rates for all coverages as of August 1, 2005; or,
 - b. A rate filing, in accordance with the new filing requirements justifying rates not reduced by at least 5%.
- iv. Rate review requirements:
 - a. Prohibiting the Board from approving rates determined to be "too high";
 - b. Obligating an insurer to justify rates based on the insurer's projected loss experience, expense and investment income and other elements considered appropriate by the Board.

- v. Introduction of a new Class of Use definitions and rating system to reflect the changes arising from (i) and (ii) above.
- vi. A prohibition against insurers increasing rates to insureds solely as a result of (i) above.
- vii. Rate implementation processes specifying:
 - a. Rate reductions to be effective 30 days following filing with the Board;
 - b. Rate increases being subject to prior approval of the Board.

RATES

On March 17, 2005 the rate freeze in effect for the period April 1, 2004 to March 17, 2005 expired. While companies could avail of the expiry to effect rate changes, none did so. Immediately prior to the expiry of the rate freeze, on March 16, 2005, Government announced its intentions with respect to additional reform measures to be proclaimed effective August 1, 2005.

In late July 2005 the Board issued revised filing instructions based on Government's announced automobile insurance reform measures. The insurers were provided one of two options: submission of a Category 1 rate filing reducing all currently approved rates for all coverages by 5% as of August 1, 2005; or, submission of a Category 2 rate filing, in accordance with the new filing requirements, justifying rates not reduced by at least 5%. These instructions provided specific directions to insurers in respect to the two options and outlined the information requirements necessary to be filed in connection with filings and expectations of the Board from companies.

The Board reviewed and accepted 21 Category 1 filings from companies opting to file currently approved rates less 5%. The Board also received 11 Category 2 filings from companies opting to submit independently justified rates based on each company's own experience and other factors. The Board subjected each of these independent filings to an in-depth review, including analysis of the company's actuarial information and cost of capital parameters, by the Board's independent consultants to ensure compliance with the filing instructions and new legislated

information requirements and to ensure that the rates were appropriate and not excessive. In general each filing sought various rate changes by coverage with some rates increasing and some rates decreasing. In all cases, the final schedule of rates approved varied from that originally proposed by the company. Details of the independent filings are available in the Board orders issued in connection with each.

Companies opting for the 5% reduction in current premiums have all implemented the reduced rates and have completed the policy review and refund activities to ensure policyholders have received the appropriate ratings as of August 1, 2005. Orders for the independent Category 2 filings were finalized just prior to March 31, 2006 and companies are currently in the process of calculating and submitting final rate schedules for verification by the Board prior to implementation. This verification process will be completed as quickly as possible.

COMPLIANCE AUDIT PROGRAM

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

The audit program is designed to ensure that insurers writing business in the Province as required under the *Act* are charging rates that have been approved by the Board. The program also ensures that agents and brokers of the insurer are interpreting the underwriting guidelines of the insurer correctly and that insureds of similar risk characteristics are being rated correctly.

During the period April 1, 2005 to March 31, 2006 the Board did not conduct any compliance audits of automobile insurers operating in the Province. The principal reason for this was that the transition and implementation of the reforms introduced on August 1, 2004 had not yet been fully completed by industry. The Board was also completing Phase II of the total insurance industry review encompassing the homeowners, commercial and marine markets.

The Board intends to continue the compliance audit program and feels that it is beneficial to all participants in the automobile insurance industry. Currently audits are scheduled to be conducted during the period June 2006 to March 2007.

MARKETPLACE CHANGES

Based on the latest information available on direct premiums written taken from the 2004 Report of the Superintendent of Insurance, there were fifty-four automobile insurers operating in Newfoundland and Labrador. This information shows that almost 90% of the automobile insurance market in the Province is written by 13 companies. The distribution of these companies by size and market share is shown in Table 1.

TABLE 1 2004 DISTRIBUTION OF COMPANIES BY SIZE AND MARKET SHARE			
Volume of Direct Premiums Written (000's \$)	Number of Companies	Percent of Market Share (%)	Total Direct Premiums Written (000's \$)
0 - 1,000	32	2.39	6,382
1,001 - 5,000	9	8.13	21,684
Over 5,000	13	89.48	238,791
Totals	54	100.00	266,857

Table 2 on the following page shows comparative information 2004 versus 2003 in relation to direct premiums written (DPW) and direct claims incurred (DCI) for automobile insurance. The total volume of DPW in the Province showed a decrease of 2.6% during 2004 while total DCI showed a decrease of 7.3%.

**TABLE 2
MARKET VOLUME
AUTOMOBILE INSURANCE
(000's \$)**

	2004 ¹	2003	\$ Change	% Change
Direct Premiums Written (DPW)	266,857	273,952	(1,095)	(2.6%)
Direct Claims Incurred (DCI)	172,569	186,222	(13,653)	(7.3%)

Table 3 contains a two-year comparative review, showing year over year relative change, of the automobile-insurance market, broken into DPW and DCI incurred by the three premium classifications, Third Party Liability, Personal Accident and Other. The Other category includes coverages such as Collision, Comprehensive, Specified Perils and All Perils. With respect to Third Party Liability, while DPW remained constant, most probably due to the rate freeze, DCI claims decreased by 10.8%.

**TABLE 3
MARKET VOLUME BY CLASS
AUTOMOBILE INSURANCE
(000's \$)**

	2004 ¹	2003	\$ change	% change
Third Party Liability DPW	181,425	181,849	(424)	(0.2%)
Third Party Liability DCI	123,535	138,469	(14,934)	(10.8%)
Personal Accident DPW	19,043	17,633	1,410	8.00%
Personal Accident DCI	12,777	10,421	2,356	22.6%
Other DPW	66,389	74,470	(8,081)	(10.8%)
Other DCI	36,257	37,332	(1,075)	(2.9%)

It should be noted that direct claims incurred does not include the overhead and operation

expenses of the company.

COMPLAINTS

During the year the Board received a limited number of complaints and inquiries. These complaints and inquiries were generally in relation to rating practices of insurers and/or agents. In addition, the Board dealt with a number of inquiries regarding rate refunds and changes arising as a result of the elimination of age, sex and marital status as rating variables.

EXPENSES

The Board's expenses related to its automobile insurance regulatory activities fall into operating, consulting and special expenses. Operating expenses are budgeted ongoing daily operational expenses related to automobile insurance regulation. Consulting expenses are associated with specific rate applications by automobile insurers requiring outside expertise and consultants' review. Special expenses are those expenses incurred by the Board in automobile insurance activities other than ongoing operations and rate filings, such as the recently completed automobile insurance review and report directed by Government. The Board is required by legislation to recover all expenses, either through its regular assessment or through special assessment from those participants in the industry regulated under the *Automobile Insurance Act* and the *Insurance Companies Act*. The Board receives no funding from any other source.

The operating expenses of the Board's Insurance Division for the 2005-06 year were budgeted at \$577,510. 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 2.00 mils or the equivalent of 0.20% of direct premiums written in the Province by the market.

Consulting expenses of \$96,944 were incurred in connection with rate filing reviews. These expenses were invoiced to each company submitting a filing requiring consultant review based on the costs associated with the company's rate filing.

Special expenses in the amount of \$778,889 were incurred by the Board in connection with the automobile insurance review conducted at the direction of Government. These costs primarily comprised participation of the Government appointed Consumer Advocate (\$197,952), retention of actuarial and other outside consultants (\$449,334), communication and advertising associated with public hearings (\$93,636), and miscellaneous Board costs involving salaries, travel, printing and related overhead (\$37,967). These one-time expenses were assessed by way of a special assessment to automobile insurers in the Province as required by s. 3.1 of the *Insurance Companies Act*.

Newfoundland & Labrador

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