

**A. I. 8 (2003)**

**IN THE MATTER OF** the *Insurance Companies Act*  
R.S.N. 1990, c. I-10, and the *Automobile Insurance*  
*Act*, R.S.N. 1990, c. A-22 as amended, and

**IN THE MATTER OF** an application by Facility Association for  
approval of revised rates to be charged for private passenger and  
commercial automobile insurance policies issued through Facility  
Association, pursuant to Section 102 of the *Insurance Companies Act*.

**BEFORE:** G. Fred Saunders,  
Presiding Chair

Gerard Martin, Q.C.  
Commissioner.

Donald Powell, C.A.  
Commissioner.

**DATE:** April 9, 2003

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Appendix B Order A.I. 30 2002-2003)

## **1.0 The Application**

On September 9, 2002 the Board of Commissioners of Public Utilities (“the Board”) received an application, pursuant to section 102 of the *Insurance Companies Act* from Facility Association (“Facility”) for approval of revised rates to be charged to private passenger and commercial automobile insurance policy holders insured by servicing carriers on behalf of Facility in all areas of the Province. The application sought average rate level increases of 41.3% for private passenger policy holders and 48.3% for commercial policy holders. A summary of the rate revisions by category and rating territory is attached as Schedule 1.

In addition, approval is being sought to:

- (a) implement the Canadian Loss Experience Automobile Rating (CLEAR) system;
- (b) introduce an integrated 10% clean driver discount for private passenger drivers;
- (c) increase accident and conviction surcharges;
- (d) change all perils premium calculation for both private passenger and commercial to be 100% of the collision premium plus 100% of the comprehensive premium;
- (e) adopt comprehensive rate group differential factors for specified perils to prevent the specified perils premiums from growing larger than the comprehensive premiums at the higher rate group levels for commercial coverages only;
- (f) change the minimum private passenger deductibles to \$250 for collision coverage and \$100 for comprehensive coverage, to be consistent with industry practice;
- (g) increase the cap on changes in class and driving record differentials for underage drivers from 5% to 7.5%;

- (h) increase minimum deductibles for commercial to \$500 for collision and \$100 for comprehensive and specified perils, to ensure that rate structures are internally consistent; and
- (i) cap the rate for commercial uninsured motorist to a base premium of \$19.

### **1.1 Notice and Pre Hearing Conference**

Public notice of the application combined with a notice of a pre-hearing conference appeared in all major newspapers circulating throughout the province commencing on October 16, 2002. The pre-hearing conference was held on November 5, 2002 at the Board's hearings room and the following parties were present:

Messrs Norman Whalen QC and Kevin Stamp QC for Facility.

Mr. Douglas Connolly representing the Department of Government Services and Lands.

Mr. Michael Kehoe representing the Taxi Operators Network.

The purposes of the pre-hearing conference were to:

1. Identify intervenors and other interested parties.
2. Establish an order of witnesses.
3. Establish an order of cross-examination of witnesses.
4. Establish a protocol and procedure for filing evidence, information requests and other submissions to the Board.
5. Identify distribution lists for the service of documents.
6. Provide focus to the issues.
7. Determine such other matters relevant to the hearing.

Following the pre-hearing conference and on November 7, 2002 the Board issued Procedural Order A.I. 29 (2002 - 2003), attached as Appendix A, establishing the rules of procedure, fixing a schedule of dates in accordance with the above list of purposes for the pre-hearing conference and setting December 11, 2002 as the start date for the public hearing into the application.

## **1.2 Intervenor**

On November 14, 2002 Peter O'Flaherty of the law firm Goodland O'Flaherty wrote the Board advising that he had been appointed, by government, as Consumer Advocate in the matter before the Board and to give notice of his intention to make application for intervenor status.

On November 15, 2002, Mr. O'Flaherty filed an intervenor's submission and a notice of motion requesting an extension to certain time limits as set out in Procedural Order A.I. 29 (2002 - 2003). Counsel for Facility had no objection to the intervention of Mr. O'Flaherty on the basis that there would not be any delay in the start of the hearing.

On November 22, 2002 the Board issued Procedural Order A.I. 30 (2002 - 2003), attached as Appendix B, granting Intervenor status to Mr. O'Flaherty and amending the schedule of dates fixed by Procedural Order A.I. 29 (2002 - 2003).

### **1.3 Participants**

During the hearing the following witnesses were called:

- For the Applicant: Brian Pelly, FCIA, FCAS,  
Partner and Consulting Actuary  
Eckler Partners, Ltd.
- David J. Simpson, M.B.A., FCIP,  
President and Chief Executive Officer of Facility.
- For the Board: Paula L. Elliot, FCAS, FCIA  
Principal and Consulting Actuary  
Mercer Risk, Finance and Insurance Consulting
- Subpoenaed by the Board: Thomas Hickey,  
Vice President,  
T.P. Hickey Insurance Limited
- David Anthony,  
President and Chief Executive Officer,  
Insurance Corporation of Newfoundland
- For the Consumer Advocate: Winston Morris,  
Superintendent of Insurance,  
Department of Government Services and Lands  
Government of Newfoundland and Labrador
- Bruce Whiffen,  
Meteorological Support Manager,  
Environment Canada.
- Sergeant John Hill,  
Officer in Charge / Traffic Enforcement Unit,  
Royal Newfoundland Constabulary

Cluney Mercer,  
Director of Highway Design and Construction,  
Department of Works, Services and Transportation  
Government of Newfoundland and Labrador.

Thomas Beckett,  
Deputy Registrar of Motor Vehicles,  
Department of Government Services and Lands  
Government of Newfoundland and Labrador

Joan Marshall,  
Acting Chairperson,  
Seniors Resource Centre Association.

The following persons appeared and gave presentations on the day set aside for public participation:

Jennifer Power,  
Senior Vice President of Operations, Atlantic Region,  
CGU Insurance Company of Canada.

Michael Kehoe,  
Co-Chair,  
Taxi Operators Network

Victoria Harnum,  
President,  
Advocates For Fair Auto Insurance

Letters of Comment were received from:

Kevin Hutchings,  
President and Secretary Treasurer,  
Metro General Insurance Corporation Ltd.,  
St. John's, NL

Doug Walsh,  
Private Citizen,  
Holyrood, NL

J.R. (Bob) Tisdale,  
President & Chief Operating Officer  
Pembroke Insurance Company,  
Markham, Ontario.

Allan Burke,  
No address given

John Emo,  
Chairman, Underwriting and Marketing Commission,  
Echelon General Insurance Company,  
Mississauga, Ontario.

Felicia M. Salomon,  
Senior Vice President & General Counsel,  
Lombard Canada Ltd.,  
Toronto, Ontario.

## **2.0 Legislative Framework and Board's Jurisdiction.**

Section 97 of the *Insurance Companies Act* creates the Facility Association and subsections 98 (1) and (2) of that *Act* sets out the governing policy of the Province, as follows:

### **Facility Association continued**

**97.** The unincorporated non-profit association of insurers known as the Facility Association is continued under the name Facility Association.

**98.** (1) An insurer licensed to transact automobile insurance in the province is a member of the association and shall be bound by the articles and by-laws of the association.

(2) The association shall, in its articles of association or by-laws and in terms not inconsistent with this Act, establish a plan to be known as the Plan of Operation

(a) to provide automobile insurance to owners and licensed operators of automobiles who would be unable to obtain that insurance without the Plan of Operation; and

(b) to provide, in accordance with sections 45.1 to 45.21 of the *Automobile Insurance Act* payment with respect to claims for damages made by persons who are not insured under a contract within the meaning of section 33 of the *Automobile Insurance Act* and who have no other insurance or who have other insurance that is inadequate with respect to the damages claimed,

and shall, in accordance with those articles of association or by-laws and this Act, establish and implement the Plan of Operation and carry out its obligations in the province with respect to that plan.

The Board has been delegated jurisdiction to supervise the rates charged for insurance coverage effected through Facility by virtue of Section 102 of the *Insurance Companies Act* as follows:

### **Rates**

**102.** (1) The association shall file with the Public Utilities Board the rates that it proposes to charge for automobile insurance placed through the association.

(2) The Public Utilities Board shall deal with a filing under subsection (1) as if it were made under subsection 49(1) of the *Automobile Insurance Act*.

(3) Subsection 49(2) and sections 51, 52, 54, 55, 56, 57 and 58 of the *Automobile Insurance Act* shall apply in connection with a filing under subsection (1).

(4) Where the rates filed in accordance with subsection (1) or the application for a change in rates under section 51 of the *Automobile Insurance Act* have been approved, the Public Utilities Board may investigate the rates charged for automobile insurance placed through the association, and notwithstanding approval of those rates, may order the association to make a change the Public Utilities Board considers appropriate.

(5) A member of the association shall not, after February 1, 1986, charge rates for automobile insurance placed through the association that have not been approved by the Public Utilities Board in accordance with this section.

Pursuant to section 57 of the *Automobile Insurance Act* the provisions of the *Public Utilities Act* RSN 1990, c.P-47 relating to the constitution, powers, procedures and practices of the Board apply to it when hearing applications for rate revisions under section 102 of the *Insurance Companies Act*.

## **2.1 Automobile Insurance Statutory Requirements**

Provincial law requires that all automobiles operated on public highways must carry minimum levels of liability insurance. Licensed auto insurers authorized to transact business in the Province are entitled to decline any risk that does not meet their underwriting guidelines. Facility exists to ensure that automobile insurance is available to every qualified driver who wishes to obtain insurance coverage regardless of risk profile.

## **2.2 Facility Operations**

The primary object of Facility is to ensure the availability of automobile insurance for owners and licensed drivers of motor vehicles who are unable to obtain such insurance in the regular market. Facility is governed by its Plan of Operation, a copy of which is attached as Schedule 2. The Plan of Operation, approved by the Superintendents of Insurance in the nine Provinces and Territories in which Facility operates, sets out its Articles of Association, Operating Principles and Rules of Operation. The Board of Directors is made up of industry executives and broker representatives from across Canada and it is the Board of Directors responsibility, among other things, to appoint servicing carriers from among those member companies applying.

The Public Utilities Board, in Order No. AI 36 (2000 - 2001), found that “...Facility is a non-profit association that operates as nothing more than an administrator of a risk-sharing automobile insurance pool. The servicing carrier companies of Facility underwrite the business risk on behalf of the member companies. Facility carries out an administration function including, *inter alia*, investment of funds, administration of the bank accounts, issuing of reports on the status of funds and accounts, distribution of members profits and issuing assessment notices for members losses incurred.”

## **3.0 The Hearing**

The public hearing commenced, as originally scheduled, on December 11, 2002 and after 12 days of hearings through December and January 2003 concluded with final written submissions on February 6, 2003 and final submissions on February 11 and 12, 2003.

### **3.1 The Automobile Insurance Industry in Newfoundland and Labrador**

#### **3.1.1 David Simpson**

During the hearing, Mr. David Simpson, President and CEO of Facility, was called by Facility to provide evidence relating to its operations in Newfoundland and Labrador and in other jurisdictions in Canada. He testified that Facility has operated in this province since 1985 and is currently comprised of the approximately 50 insurers operating in Newfoundland and Labrador who collectively provide automobile insurance to persons who no one insurer individually wishes to write. They are described by the industry as “the high risk group” and, traditionally, the claims and administrative costs associated with them are higher than in the regular market.

Since the last Facility hearing, up to which time the insurance industry did not indicate to their clients that their policies were being placed through Facility, a brochure has been introduced and circulated to clients explaining Facility’s role in the auto insurance industry and Facility is now named on automobile insurance policies. Previously a person could be placed in Facility and not be aware of it. Consequently, the role of Facility within the automobile insurance framework of Newfoundland and Labrador had become something of an enigma to the consuming public.

Mr. Simpson described the automobile insurance industry as being made up of three segments of insurers and that the premiums applicable to the three industry segments are established based on the loss experience results. The three segments can be described as the regular market segment, comprising the low to medium risk drivers, the grey market segment comprising the medium to high risk group and Facility, which is the market of last resort, comprising the high risk group

who cannot obtain insurance in the other two markets. (Note: For the purposes of this order the grey market segment is included in any reference to the regular market segment unless otherwise specified)

There are rules which govern a person's acceptance in either one of the industry segments. These rules are commonly referred to as "underwriting guidelines" and they incorporate various qualifying factors, for example, age and type of automobile, driving record, the number of accidents, convictions and claims a person may have.

In 2001 the total number of private passenger vehicles insured in Newfoundland and Labrador was 218,192 of which 8,372 (3.8%) were insured through Facility. As well, there were 17,969 commercial vehicles insured of which 408 (2.3%) were placed through Facility.

Mr. Simpson testified that all automobile insurance companies operating in Newfoundland and Labrador are required, by law, to be members of Facility. They are required to share the risk according to a formula based on the portion of the premiums they write in relation to the total premiums written in the Province. The Plan of Operation allows Facility to appoint servicing carriers, of which there are four in this Province, who issue the policies on behalf of Facility. The servicing carrier issuing the policy is named as the insurer. All applications for automobile insurance to be placed through Facility are completed by brokers and agents employed by or on behalf of any of the approximately 50 member companies. The applications must be submitted to one of the four servicing carriers to be audited and checked before a policy is issued. No

person can be refused automobile insurance coverage regardless of the risk, providing they are prepared to pay the approved rates. There are seven servicing carriers appointed in all of Canada and four of them are appointed and approved to operate in this Province. They are:

Insurance Corporation of Newfoundland

Cooperators General Insurance Company

Royal & Sun Alliance Insurance Company of Canada

Unifund Assurance Company

Mr. Simpson stated that Facility has its offices in Toronto and has a staff of 14 supported by approximately 80 industry volunteers from across Canada and local operating committees in every jurisdiction to deal with local issues. The costs of running Facility, including salaries, rent, office supplies etc., are allocated, based on premium volume, among the member companies throughout the nine jurisdictions in which Facility operates.

Servicing carriers enter into operating agreements with brokers. Usually a broker is affiliated with only one servicing carrier and both groups are compensated for their work through a schedule of fees contained in the Plan of Operation. To ensure standardization is achieved Facility issues rules (underwriting guidelines) and approved rates to all servicing carriers and brokers.

The Board heard evidence from three industry representatives who described their involvement in the Newfoundland and Labrador automobile insurance industry.

**3.1.2 Jennifer Power**

Ms Jennifer Power, Senior Vice-President for the Atlantic Region of CGU Insurance Company of Canada, one of the largest property and casualty insurance groups in the country, in describing her company's operations stated that CGU owns four companies which write \$43 million, or 23% of the automobile insurance sold in Newfoundland and Labrador. CGU operates in this province through a network of brokers and does not maintain an office. She testified that her company is in a loss position based on 2001 results of its Facility business in Newfoundland and Labrador and that current rate levels are inadequate.(Transcript, Jan.14, p 2, ln 1-18). She explained the relationship of the regular and grey markets to the Facility market and emphasized the need for the Board to establish appropriate rate levels so as to provide an environment to enable insurance companies to offer options to its customers. Under cross examination by the Consumer Advocate, Ms Power agreed that underwriting practices in the present market will become much tighter and rates will increase.(Transcript, Jan.14, p.8 and 9)

Ms Power described the automobile insurance product available in Newfoundland and Labrador as being a "tort product" (Transcript, Jan. 14, p 12, ln 27) which carries with it the ability for a person to sue for loss of income, pain and suffering. This differs from the product available in Ontario which she described as a "no-fault product" which eliminates a considerable amount of litigation from the system.

**3.1.3 Thomas Hickey**

Mr. Thomas Hickey, Vice-President of T.P. Hickey Insurance Limited, gave evidence relating to his involvement in the automobile insurance industry. He has been in the business for 19 years and is a member and executive of several industry associations and organizations. Mr. Hickey stated that his company is strictly a brokerage representing various insurance companies. He explained that it buys insurance for its clients from the insurance companies, some of which it has contractual relationships with. Mr. Hickey stated that as a broker the relationship to Facility is through the servicing carrier with whom they are contracted to place business.

Mr. Hickey, in describing the process of determining whether or not a client gets placed in Facility, stated that his company first determines if the coverage is available in the regular market. If the underwriting guidelines of the regular market insurers, as applied to the application, indicate that the risk precludes coverage being obtained in the regular market, and provided its client is satisfied that no other broker can accommodate him in the regular market, his company will offer its client a rate quote with Facility. If the client accepts the quote he pays the premium which is deposited in a trust account. Within two or three days of receiving the premium from the client, and once the coverage is bound, a temporary liability card is issued to the client. Facility, through its servicing carrier, processes the application and issues a policy to the client through the broker. This ensures that the broker / client relationship is maintained. Mr. Hickey pointed out that his company places emphasis on maintaining long-term relationships with its clients and this contributes to the 50 % retention rate his company enjoys on Facility policy holders once they exit Facility.

In testifying on the reasons people end up in Facility, Mr. Hickey emphasized that each case is different and that the length of the relationship that exists between the client and his brokerage contributes considerably to the decision to place the client in Facility. Otherwise the decision to place a client in Facility is strictly governed by the underwriting guidelines. Mr. Hickey suggested that other than accidents and convictions there are many reasons why a person ends up in Facility. For example, they may be a new Canadian having previously driven in a country where the law requires you to drive on the left or it may be a case where the client drives a high risk automobile or “muscle car” e.g. a Stingray. Another reason to place a client in Facility may relate to the fact that they are a new driver or are underage.

Mr. Hickey said that information gathered through a binder control mechanism, similar to that which is in place in some other provinces, would be useful to all the stakeholders in this province as it would provide valuable information on the reasons why people get placed in Facility. In addition, he felt it would make brokers more conscious of their decision to place a person in Facility and serve as an analytical tool to address specific problems.

In respect of the present rates he felt that the rates in the regular market had “caught up” to the Facility rates for some coverages and this was a difficult environment in which to operate since, in some cases, the Facility rate for high risk drivers is lower than the regular market rate. This also presents a problem to the grey market insurers whose rates are designed to attract the best of the worst drivers from the Facility market.

Mr. Hickey in explaining how people get out of Facility testified that policies come up for review 60 days before renewal time. At that time the clients' profile is examined to determine if a change in circumstances has occurred that would allow the client to be moved out of Facility. If such a change has occurred it may be possible to move the client to the grey market and then in the following year, providing the experience continues to improve, move them to the regular market.

In response to questions from Facility Counsel, Mr. Hickey described the dilemma faced by the automobile insurance industry in Newfoundland and Labrador in attracting more insurers to the market. The reasons for this, he stated, stretch far beyond the provincial boundaries and relate to economic conditions worldwide. In a tight market environment insurance companies will opt to pull out and invest in other, more lucrative markets. He suggested there is very little opportunity to compete with the larger markets because the local insurance market is very small, by comparison and, therefore, offers fewer opportunities for growth.

While still under questioning by Facility Counsel and, later by the Consumer Advocate, Mr. Hickey stated that Facility's role in the automobile insurance structure in this province is not very well understood by consumers. He believes this can be attributed to the fact, as he has observed, that people are primarily concerned with the level of premium they have to pay for insurance and not with who, in the structure, is providing the coverage beyond the broker representative. He informed the Board, however, that the name "Facility" now appears on all documents his company provides to its clients.

### **3.1.4 David Anthony**

Mr. David Anthony, President and CEO of Insurance Corporation of Newfoundland (ICON), an insurance company and a servicing carrier for Facility was called and gave evidence on the role of a servicing carrier in the automobile insurance structure of Newfoundland and Labrador. Mr. Anthony is also President and CEO of Anthony Insurance Incorporated, an insurance broker. Mr. Anthony has been in the business of insurance for 30 years and his company has existed since 1962. He is a member of and has served on the executive of several industry associations and organizations.

Presently, ICON sells insurance through Anthony Insurance, its only broker, which is exclusive to ICON. Mr. Anthony stated as a servicing carrier for Facility, ICON has contracts with eight brokers and that if there was an opportunity for Anthony Insurance to contract with other insurers it would do so.

In respect of Facility business Mr. Anthony explained that ICON supplies Facility underwriting manuals and application forms to its brokers. The applications bear the name “Facility Association”.

ICON, the servicing carrier, does not make any underwriting decisions regarding who goes in or out of Facility. The application, when completed by the broker is forwarded to ICON who audits it for correctness and obtains a driver abstract from Motor Registration and a claims history from Auto Plus, a service provided by the Insurers Advisory Organization. If the application is correct

and the driving record and claims history are in accordance with the information supplied on the application a policy is issued through the broker. At the same time ICON supplies the broker with any brochures or other information the customer should be aware of.

Mr. Anthony testified that at month end a list of written policies is sent to each broker showing its Facility activity for the previous month. The list contains a summary of the premium amounts, commissions and taxes. The broker remits a cheque to ICON and it is deposited in a central clearing bank account. The funds are then transferred to Facility who manages the main Facility account and invests the funds on behalf of the members. In the event of a Facility claim ICON settles on behalf of Facility and issues a claim cheque.

Administratively, and for the purpose of recovering commissions and fees from the Facility business, reports are forwarded monthly and when approved by Facility a cheque is drawn by ICON on the Facility clearing house account. Facility forwards a participation report to its members monthly showing each members share of the total automobile insurance market for the previous month as well as the amount of Facility business written. At the end of the year, in accordance with the Plan of Operation approved by the Superintendent of Insurance, any surplus or deficit remaining in the Facility accounts after all claims, commissions, and expenses are paid out are distributed to, or assessed against, the members based on their share of the total automobile insurance market in Newfoundland and Labrador.

Mr. Anthony explained that the turnover of clients in Facility is in excess of 50 % and this adds to the cost of handling the business. His company regards Facility business as an opportunity to groom a relationship with a client so that when they move out of Facility they will continue to maintain their business with ICON and Anthony Insurance.

Regarding the decision as to who gets placed in Facility, Mr. Anthony stated that the brokers make that decision based on their interpretation of the underwriting guidelines of the insurers they represent. The broker is also cautious in ensuring that the risks they are proposing are distributed as evenly as possible among the insurers they represent so as to avoid loading high or low risk drivers on one particular insurer.

In relation to why drivers are placed in Facility, Mr. Anthony stated that it is unfortunate that the binder control register discussed at the last hearing and again during this proceeding has not been adopted for use in this province. He suggested it would be of value in future hearings if such a mechanism were put in place as it would lead to a more informed discussion on the type of driver being placed in Facility. In the meantime, he stated that a person gets placed in Facility for one or more reasons which the industry uses to assess the risk involved. Different underwriting guidelines exist among insurers and the criteria varies from company to company. He doubted, for example, that seniors get placed in Facility for reasons of age alone. He suggested that age may be a determining factor when combined with other reasons which may be as simple as the length of the relationship between the client and the company. Insurers strive to develop and maintain long-term business relationships with their clients since renewal business comes with lower administrative expense.

On the question of cross subsidization, Mr. Anthony stated that cross-subsidization does occur in that when setting rates for the general or regular market you start with an expected ROE, determine the anticipated expenses and calculate the required premiums. He testified that “If Facility rates in their own right aren’t adequate to cover the losses of Facility through the mechanism of picking up this loss, it gets transferred down to the general market, and then it becomes subsidized” (Transcript, Jan.15, p.10, ln 14 - 17). He explained that if the Facility business results in a surplus the reverse is achieved. Mr. Anthony agreed that over the past 17 years the regular market has benefitted by an amount equal to 2.5 % of the written premium in Facility ((Transcript Jan.15, p 11, ln 51).

The tight market conditions experienced over the recent past, according to Mr. Anthony, has caused insurers to become more selective in writing new business because of the increased possibility of incurring a loss. He stated that when these conditions exist “you tend to sort of turn the tap off until you get to where you are comfortable with the rate...” (Transcript, Jan. 15, p 12, ln 41) He described 2001 as the worst underwriting year most companies have ever had in Newfoundland and Labrador. As a result, he said, rates in the regular market have increased 30 % to 40 % over the last 24 months. He stated that you have to try very hard to protect the book of business you have and that translates into increased rates and tightening the underwriting guidelines resulting in an increased population in Facility and the grey market.

In response to the Consumer Advocate's questions relating to the impact of claims costs on profits Mr. Anthony stated that ICON's claims in 2001 were 9% higher than in 2000 and in 2002 the increase was 12 % higher than in 2001. He added that these increases are mainly attributed to a higher incidence of soft tissue injuries.

On further questioning by the Consumer Advocate, Mr. Anthony said that because of recent rate increases the automobile insurance market in this province is beginning to stabilize after a period of four years without any increases in rates. This, he said, gives rise to another problem that approval of this Facility application will alleviate and that is the regular market rates have gotten too close to the Facility rates. When that situation exists, he explained, it is possible for high-risk drivers to be paying less for their insurance than drivers in the regular market.

Mr. Anthony disagreed with the Consumer Advocate's suggestion that a poor investment climate went together with poor profit opportunities. He stated that when the investment climate is good it makes it easier for the companies to attain ROE and, this, he suggested is ultimately of benefit to the consumer.

Mr. Anthony was asked if there was any mechanism in place to inform Motor Registration Division of cancellations of mandatory insurance. He explained that a system was in place some years ago but it was discontinued by Motor Registration when it was found that they had difficulty coping with the volume of cancellation notices. He described the experience as an "unmitigated disaster" (Transcript, Jan. 15, p 50, ln 75).

The Board believes that compilation of statistical information relating to insureds placed in Facility would provide useful information for future hearings and aid in the Board's regulatory supervision of the rates of Facility.

**The Board will order Facility to commence gathering statistical information at the same time as the rates resulting from this Order are implemented and in the form, generally, as indicated in the attached Schedule 3 which may be amended by the Board from time to time.**

### **3.2 Evidence of the Consumer Advocate's Witnesses**

#### **3.2.1 Winston Morris**

Mr. Winston Morris, Superintendent of Insurance, testified that one of his responsibilities is to ensure that all automobile policies issued by insurers in the province contain the mandatory minimum coverages prescribed by the *Automobile Insurance Act, R.S.N., 1990 c. A-22*. He pointed out that it is an offence under the *Highway Traffic Act* to operate, or being the owner of a vehicle, to allow another person to operate any motor vehicle on the highway in this province unless there is in force with respect to the motor vehicle a valid policy of insurance in the form prescribed by the *Automobile Insurance Act* and approved by the Superintendent of Insurance.

Mr. Morris described the automobile insurance industry in the province and stated that Facility is required under section 103 of the *Insurance Companies Act* to provide information and financial statements to the Superintendent as may be required from time to time.

In commenting on “profits” generated by Facility’s operation in Newfoundland and Labrador and in other jurisdictions, Mr. Morris stated that it was his understanding, despite the fact that Facility’s rates make no provision for profit, their operations in this province have generated profits in most of the years it has operated here.

Counsel for Facility argued that “There may well be differing views as to the implications for profitability based on the present legislation, and whether that legislation, properly interpreted prohibits member companies from directing Facility Association to, from time to time, file for rates which include a profit component.” (Facility Argument, p.34). He went on to argue that in the present application and in all previous applications which have been filed by Facility, rates have been proposed on an intended breakeven basis and the revenue generated is only intended to cover the operating expenses of Facility and the direct expenses of its members.

The Consumer Advocate submitted that “...a zero profit provision is a requirement of the existing legislative scheme for automobile insurance in the province...” and “...that, under provincial law, consumers who are required to obtain auto insurance through the Facility Association mechanism are entitled to purchase that product at a price established by calculating the level of rates required to cover only the claims and expenses that will be incurred by Facility Association, with no profit provision.” (Consumer Advocate Argument, p. 18)

The proposed rates which are based on anticipated future events may or may not generate a profit for the members of Facility. That is a risk assumed by the industry.

The Board, in its Order AI 36 (2000 - 2001), ruled on the matter of Facility's surpluses and deficits and concluded that Facility is a non-profit association that operates as nothing more than the administrator of a risk-sharing automobile insurance pool.

The general consensus at the hearing was that the format of the financial statements, copies of which were filed by Facility in this hearing, is that there is an element of confusion among the parties respecting the day-to-day operations of Facility and its mandate to act as an administrator of the premiums collected by its member companies.

**The Board will require Facility, in future rate revisions, to separate its financial statements reflecting on the one hand, its internal administrative revenues and expenses and, on the other, the results of its activities as manager of its members pooled funds.**

### **3.2.2 Bruce Whiffen**

Mr. Bruce Whiffen, Meteorological Support Manager with Environment Canada, was called as a witness by the Consumer Advocate to place on the record an analysis of the climatological data relating to the winter of 2000 - 2001 in the St. John's area. Mr. Whiffen concluded that during that winter St. John's broke its all-time record for total snowfall and that there was an abnormally high frequency of winter storms and record accumulation due to lower rainfall and colder temperatures than normal resulting in reduced snowmelt and consequent record snow depth.

### **3.2.3 Sgt. John Hill**

Sgt. John Hill, Officer in Charge of the Traffic Enforcement Unit of the Royal Newfoundland Constabulary (RNC) at St. John's, testified that he maintains records of all motor vehicle accidents in the St. John's area. He concluded that during the winter of 2000 - 2001 there was an increase in the number of motor vehicle accidents reported to the RNC and that there was a correlation to be drawn between the poor driving conditions caused by the weather and the number of accidents.

Sgt. Hill testified under cross-examination that during 2001 there were 3901 accidents reported within the Royal Newfoundland Constabulary area of the North East Avalon and that 790 of those drivers were charged with operating a motor vehicle without having the mandatory insurance coverage in effect at the time of their involvement in the accident.

Sgt. Hill testified that he has noticed a decrease in traffic accidents following public announcements of traffic check points and other public awareness campaigns carried out by the Royal Newfoundland Constabulary.

### **3.2.4 Cluney Mercer**

Mr. Cluney Mercer, Director of Highway Design and Construction, Department of Works, Services and Transportation gave evidence relating to the inventory of public roads in the province, the percentage of paved roads and the classification of roads.

**3.2.5 Thomas Beckett**

Mr. Thomas Beckett, Deputy Registrar of Motor Vehicles, Department of Government Services and Lands testified with respect to the number of drivers and vehicles that are licensed to operate on the highways in Newfoundland and Labrador. He stated that there are 226,292 private passenger vehicles, 89,598 commercial vehicles and approximately 350,000 drivers registered.

Under cross-examination, Mr. Beckett stated that there is no mechanism in place to enforce the mandatory insurance requirements except for those vehicles and drivers who are subjected to highway check points or are stopped for violations of the Highway Traffic Act.

**3.2.6 Joan Marshall**

Mrs. Joan Marshall, Acting Chairperson of the Seniors Resource Center Association of Newfoundland and Labrador, provided statistics on the population of senior citizens in the province and commented on the difficulties some seniors would encounter if Facility rates were allowed to increase. She agreed, however, that seniors responsibilities were similar to those of younger drivers and that there should be no price discrimination, based on age.

The evidence presented by Facility in response to the Consumer Advocate's Request For Information #2.0 and the evidence contained in Information # 4 filed during the hearing relating to the demographics of people in Facility discloses that for persons age 50 and over, a disproportionately smaller percentage are insured through Facility than in the regular market.

Mr. Hickey and Mr. Anthony both stated that they had not seen any indication that people were being placed in Facility solely as a result of age.

### **3.3 Presentations by the Public**

Three persons responded to the Board's invitation to the public to avail of the opportunity to make a presentation on Facility's rates.

#### **3.3.1 Jennifer Power**

Ms Jennifer Power, Senior Vice-President for the Atlantic Region of CGU Insurance Company of Canada, gave evidence which the Board dealt with elsewhere in this order in the section headed "The Automobile Insurance Industry in Newfoundland and Labrador".

#### **3.3.2 Victoria Harnum**

Ms Victoria Harnum, President, Advocates for Fair Auto Insurance, testified that the aim of her Association, which has been in place since 1999, is to educate the public on how insurance works. Ms Harnum stated that she is involved in research and education with the Association and has determined that "...a lot of drivers do not even know they are placed in this high risk group." (Transcript, Jan. 14, p. 16, ln 12).

It was Ms Harnum's opinion that the public has a right to know if they're in Facility and why they are there and "There has to be a clear written criteria as to how a driver becomes a high risk driver, how long they will be considered a high risk driver and what they need to do to get out. All we ask is for the insurance industry to be fair, accountable and open." (Transcript, Jan. 14, p. 16, ln 60)

Ms Harnum summarized her efforts to date to convince government, the auto insurance industry and the regulators to initiate reforms to make insurance more affordable and the industry more accountable.

### **3.3.3 Michael Kehoe**

Mr. Michael Kehoe, Co-Chair of the Taxi Operators Network, described his experiences with the automobile insurance industry. Mr. Kehoe has been involved in the taxi business for about ten years as a driver, owner and operator. He described the Taxi Operators Network as an unincorporated facilitative agency of volunteers who are trying to improve the lot of the taxi industry. He stated that they work closely with Hospitality Newfoundland and Labrador, the Cruise Ship Authority, the Airport Authority, the taxi owners and the City of St. John's. He also described the Network's involvement with the Environmental Industries Association, the Conservation Corps of Newfoundland and Labrador, the Department of Works, Services and Transportation and the City of St. John's to reduce greenhouse gas emissions through a program called "Smart Taxis Encourage Environmental Respect". The Network also has a project with the Independent Living Resource Council to promote the accessibility of taxis for wheelchair passengers and has established a committee to focus on women in the taxi industry.

Mr. Kehoe testified that many of his Network's members and others in the taxi industry are barely making ends meet and that they are concerned about the increases being sought by Facility. He described the difficulty encountered by members of his industry in their efforts to get out of Facility once they are placed there. Mr. Kehoe stated that taxi fares are regulated by

the City of St. John's and the City also determines the number of taxis that can be operated and the regulations relating to driver conduct and vehicle condition.

### **3.4 The Actuarial Evidence**

#### **3.4.1 Rates - General**

In proposing rates, Facility, on behalf of its members, seeks to recover claims and administrative costs but makes no provision for profit. After all premiums, claims costs, administrative costs, and interest are accounted for, any surplus is distributed among the member companies in accordance with a formula based on each company's portion of the total industry volume written. By the same formula, any deficit is assessed against the member companies (See Article V of the Plan of Operation approved by the Superintendent of Insurance). To the end of 2001, after 17 years of operation in Newfoundland and Labrador, Facility has a cumulative surplus of approximately 2.5% of total premiums written without an adjustment for inflation.

Rates in the regular market are established through a benchmark system which is subject to this Board's approval and supervision. The benchmark system has been in place since the Board was given responsibility to regulate automobile insurance rates, and is actuarially based on loss experience in the regular market. The system provides for a range of rates with minimum and maximum parameters. Within the prescribed range the Board grants approval without further actuarial justification. Insurers who wish to operate outside the prescribed range are required to actuarially justify the rates they propose to charge. The actuarial process employed to determine rates in the regular market is similar to the process in place for Facility rates. The differences to

be found in the rates of Facility and the regular market are primarily influenced by the differences in claims costs and the profit margin built into the regular market rates.

The Board, having considered the evidence and arguments submitted in support of and contrary to the Facility proposal, has the obligation, acting judicially, to determine which rates will best reflect the future cost of automobile insurance provided through the Facility mechanism.

### **3.4.2 Actuarial Judgement**

The challenge in setting prospective rates is to reach a decision which reasonably anticipates the future. In reaching this determination the Board relies on the opinions of actuarial experts as to the reasonable expectation for the future based upon an analysis of past events. Given the amount of judgment involved in actuarial decisions it is not unusual to have differing expert opinions. When that occurs, as it does in this matter, the Board must decide what actuarial evidence best anticipates future realities and thus, future rates.

Mr. Pelly testified that the principal role of a pricing actuary is to use available experience from the past to build an expectation for the future with respect to the costs that relate to the coverages being provided under the automobile policy. (Transcript, Dec. 11, p.14, ln 17 - 24). He further stated that the structure of the rates is established through a system of multiplicative differentials which are factors that are used to explode the base rate out to a specific rate for an individual rating cell, be it for a territory, a class, a driving record, a liability limit, a particular rate group or deductible and that all of those rating cells represent dimensions of the classification process.

The differentials are then used to populate the various rating cells in each of the dimensions.

(Transcript, Dec.11, p.18, ln.57 - 66)

Actuarial analysis begins with estimates of the ultimate claims cost reserve which is made up of amounts already paid plus additional amounts that are predicted to be paid out in future. These reserves are then subjected to the application of loss development factors to account for the potential increase or decrease in claims cost over time. These loss development factors can be significant and result in substantial increases in incurred losses especially in bodily injury claims.

Following the application of loss development factors, trend factors are applied to the loss costs as a means of adjusting the historical data to make it relevant to a future rating period. Trend factors, which the actuary will use to build an understanding of the long-term patterns of change, can also have significant impact on future rates.

The Board heard evidence from two actuaries, Mr. Brian Pelly of Eckler Partners Ltd on behalf of the applicant and Ms. Paula Elliot of Mercer Risk, Financial and Insurance Consulting who was called as a witness by Board Counsel. While both actuaries recommended significant increases in Facility rates there was a wide difference of opinion as to the level of rates appropriate for Facility for the period commencing February 1, 2003. Both actuaries relied upon the data provided by the Insurance Bureau of Canada (IBC) and while the data was not audited it was found by both to be reliable.

The Board attaches a high degree of credibility to the analysis, projections and judgments employed by both Mr. Pelly and Ms. Elliot and accepts that where they differ in the results is a matter of interpretation of the data or a reflection of their actuarial judgment, or both. For example, whether to use annual or half-yearly data, five or ten years history, separate analysis of bodily injury and property damage or an unemployment variable is an individual actuarial judgment. The process being prospective precludes a final assessment of the judgment employed by the actuaries until future events become history. For the present application and its numerous components it remains for the Board to make its own judgments on the various proposals of Mr. Pelly and the recommendations of Ms. Elliot based on the evidence and arguments submitted at the hearing.

In selecting loss development factors Mr. Pelly stated you are trying to “decide on a balance between stability and responsiveness”. He went on to explain that “stability” is looking to the longer term, or taking a longer term view, and “responsiveness” is being more responsive to the latest experience. (Transcript,. Dec.12, p.2, ln 71 - 84)

In determining rates, Mr. Pelly explained that he predicts claims for each year of occurrence by applying loss development factors to existing reserves. These factors reflect inadequacies in the reserves as a result of both inaccurate reserving and unreported claims. The first step in the calculation of these loss development factors is the determination of the number of years of experience to be included in the analysis. Once the period is determined an actuary may exclude a historical data point within the period if it is determined to be an outlier. An outlier is a data

point which is not representative or characteristic of future expectations. An actuary may exercise his judgment to exclude an outlier from the calculation of data point averages in determining the particular loss development factor at each interval.

The differences in analytical and statistical methods used in the judgments of the two actuaries result in recommended rate levels that are substantially different as shown by the following table:

<u>Coverage</u>	<u>Facility Proposed Rate</u>	<u>Mercer Recommended Rates</u>
<b><u>Private Passenger</u></b>		
(average all territories combined)		
Third Party Liability	+51.7 %	+31.5 %
Accident Benefits	+13.8	+15.7
Uninsured Auto	+45.8	+43.1
Collision	- 5.5	- 10.1
Comprehensive	- 14.1	- 17.3
Specified Perils	- 20.5	- 34.4
<b>Overall</b>	<b>+41.3 %</b>	<b>+24.4 %</b>
<b><u>Commercial *</u></b>		
(average)		
Third Party Liability	+59.2 %	+38.4 %
Accident Benefits	- 12.3	- 13.0
Uninsured Auto	+216.7	+ 90.2
Collision	+20.4	+ 19.0
Comprehensive	- 18.4	- 18.9
Specified Perils	- 43.9	- 48.8
<b>Overall</b>	<b>+48.3 %</b>	<b>+30.7 %</b>

\* commercial is the same for all areas of the Province

In his argument, (p.5 & 6) Counsel for Facility translated the percentage differences between the two actuarial opinions into dollar value differences based on 2001 on-level premium values of \$11,400,000 for private passenger and \$623,000 for commercial vehicles. Applying the percentage increases proposed by Mr. Pelly to these on-level premium values results in an increase of \$4,708,200 for private passenger and \$301,000 for commercial vehicles. A total increase of \$5,009,200. Using Ms. Elliot's recommended percentage increases, on the other hand, results in increases in on-level premiums of \$2,781,600 for private passenger and \$191,000 for commercial vehicles. A total increase of \$2,972,600. The difference is primarily made up of the difference between the two actuaries resulting from the method of selection of private passenger loss development factors.

### **3.4.3 Accident and Conviction Surcharge**

Facility seeks approval of changes to the Accident/Conviction Surcharge Schedule which will result in increases to the surcharges. The new schedule will apply to all classes of private passenger and commercial vehicles as set out in the application.

The changes to the Accident/Conviction Surcharge Schedule are proposed as an integrated revenue neutral package with the Clean Driver Discount. The integrated package is proposed uniformly throughout all jurisdictions in which Facility operates and is intended to influence driver behaviour.

While the Board acknowledges that Facility seeks to have uniformity across all the jurisdictions in which it operates the Board will not base its decision solely on this objective. Facility must provide sufficient evidence and justification for all of its proposals.

Facility admits that this proposal is not actuarially justified but is rather judgementally based. Evidence was adduced to show that the surcharges are calculated as a percentage of the premium which means that where the premium is increased, as Facility has sought to do here, the absolute dollar amount of the surcharge will increase proportionally.

The Board finds that there was insufficient evidence to justify the changes to the Accident Conviction Surcharge Schedule proposed by Facility. The Board believes that the current surcharges are adequate to discourage poor driving and properly allocate loss costs.

**The Board will not accept the proposal to change the Accident/Conviction Surcharge Schedule.**

#### **3.4.4 Private Passenger Loss Development Factors**

There are two basic differences between Mr. Pelly's proposals and Ms. Elliot's recommendations in respect of their loss trend development methodologies. They are:

1. The selection and exclusion of outliers; and
2. The use of straight average versus weighted average.

#### **3.4.4.1 Outliers**

Mr. Pelly explained that his report was prepared on a “best estimate basis” (Transcript, Dec. 11, p.15, ln.23) seeking to fix indications at the middle of any range. He said that if a particular data point was not characteristic of what is expected to occur in a future period then it was appropriate to exclude it from the selection. He acknowledged that identifying an outlier is a judgmental process in which actuaries routinely engage and in his selection of loss development factors for private passenger bodily injury and accident benefits coverages he made a judgment to exclude certain data points he deemed to be “outliers”. All of the data points selected by Mr. Pelly were low.

Ms. Elliot disagreed with this approach and stated that she would only exclude a data point if it could be shown to have been a mistake or error. It is this difference of opinion in the selection of loss development factors for private passenger bodily injury coverage that constitutes 70 % of the difference between Mr. Pelly’s rate proposals and Ms. Elliot’s recommendations.

Ms. Elliot found the bodily injury loss development factors selected by Facility to be relatively high and was concerned that Facility did not provide its rationale for the years (data points) that it excluded from its selection. Ms Elliot also noted that in each case where Facility did not select the five-year average, it selected an average that excludes the year(s) with the lowest development factor which has the effect of increasing the average loss development factor which, in turn, results in a correspondingly higher rate level indication. The factors selected by Facility were primarily based on its loss development experience in Newfoundland and Labrador

as published in the Facility 2001 AIX development exhibits compiled and published by the Insurance Bureau of Canada. For those coverages where the Newfoundland and Labrador data was not deemed to be sufficiently credible Facility used its loss development experience in the Atlantic region and the industry overall.

For collision and comprehensive coverages Facility selected loss development factors equal to the average of the factors that had been experienced over the last five years which Ms. Elliot found to be reasonable.

The Board is not satisfied that the applicant has provided sound reasons for the identification and elimination of certain low data points in the development of the loss trends for private passenger bodily injury and accident benefits coverages. The Board finds the recommendation of Ms. Elliot to be more reasonable and balanced than the approach taken by Facility.

**The Board will not accept the private passenger bodily injury and accident benefits loss development factors proposed by Facility and will require Facility to develop loss development factors without the exclusion any data points.**

#### **3.4.4.2 Average**

As pointed out by the Consumer Advocate in argument (Consumer Advocate written argument p.30) Mr. Pelly used the straight or arithmetic average of the factors experienced over the previous five years of data. Ms. Elliot on the other hand recommended the use of a weighted

average which, she claimed, would give greater emphasis to the most recent loss experience and proportionally lesser weight to the older experience. Both actuaries acknowledged that either approach is actuarially acceptable.

**The Board will accept the arithmetic average employed by Mr. Pelly.**

#### **3.4.5 Private Passenger Trend Selection**

Following the development of historical loss costs by accident year to their anticipated ultimate value a trend factor is applied to determine how costs are likely to change in the future policy period. There are a number of issues to be determined in the calculation of loss trend.

#### **3.4.6 Number of Years of Historical Data**

The number of years of historical data to be used determines the pattern of change over time. Ms. Elliot recommends the use of a ten year period for the analysis of bodily injury trend, a ten year period for the analysis of property damage coverages severity trend and a five year period for the analysis of property damage coverages frequency trend. The periods adopted by Mr. Pelly in developing loss trend vary from coverage to coverage and extend back in the case of severity as far as 1984 for certain property coverages. The Consumer Advocate argued that either approach is an acceptable actuarial practice (Consumer Advocate written argument p.32) but he favours the approach adopted by Ms. Elliot which he describes as straight forward and consistent and more responsive to recent data. Mr. Pelly testified that the use of periods of inadequate duration exposes the risk of very significant shifts and fluctuations moving from one year's analysis to the

next. One of the methods of measuring the adequacy of a regression is the use of statistical tests which he pointed out resulted in his model showing superior results to Ms. Elliot's model in every case examined.

**The Board will accept the number of years of historical data adopted by Mr. Pelly for the development of loss costs by accident year and believes their adoption will reduce the risk in moving from one year's data to the next.**

#### **3.4.7 Private Passenger Unemployment Variable**

Mr. Pelly used an unemployment variable as a surrogate to determine if a correlation exists between an economic cycle and claims experience. He testified that "...every coverage for which we have to do a trending estimate, we do test the statistical significance of including an unemployment variable to capture the influence of the economic cycle" (Transcript, Dec. 11, p 29, ln 64) He believed there was an intuitive explanation and justification for the use of that variable in the analysis of certain coverages. He suggested that in times of high unemployment drivers may use their vehicles less frequently resulting in a correspondingly lower frequency of property damage. He explained that the unemployment variable is not statistically significant for most coverages but when tested in developing property damage frequencies for private passenger trend in this instance he found it "...gave us a pattern of change in the fitted curve..." (Transcript, Dec. 11, p 29, ln 71).

Ms. Elliot objected to the use of the unemployment variable and stated at page 16 of her report that its effect is rather dramatic. She explained that the decline in the unemployment rate variable has the effect of increasing the estimated frequency trend, and as a result increases the indicated rate level. She also did not recommend the use of the unemployment variable in this application because "...it's dependant upon a forecast provided by another source, and in this case, the Conference Board of Canada, and if that source is perhaps wrong in its projections, then the estimate of the future costs will be wrong, and this is a big unknown to enter into the model..." (Transcript, Dec. 19, p 3, ln 26).

The Consumer Advocate argued that the unemployment variable should not be considered by the Board in this application because unemployment rates are at historically low levels in the St. John's area and at chronic high levels in other areas of the province adding a degree of uncertainty and unreliability to the calculation of loss trends.

Counsel for Facility, in his final submission, argued that the whole of the actuarial process is itself nothing more than a forecasting exercise and that Ms. Elliot's objection to the use of the unemployment variable is weakened by the fact that she used the same approach in her reports to the Board concerning the 2002 and 2003 benchmark rates for the regular market.

The Board is satisfied that the use of the unemployment variable is reasonable given that it is an acceptable actuarial practice which was verified as being relevant by Mr. Pelly's statistical analysis.

**The Board will accept the use of an unemployment variable as proposed by Facility as proposed by Facility.**

### **3.4.8 Private Passenger Annual and Half-Year Data**

In discussing the use of annual versus half-year data Mr. Pelly suggests that the small number of vehicles in the total insured fleet in Newfoundland and Labrador makes it impractical to use half-year data in constructing regression models. He suggests that if half-year data is used it becomes necessary to incorporate seasonality as an added feature into the model. This creates a seesaw pattern and requires more sophistication in the model. He also believes this adds "noise" and uncertainty, raises concerns with the credibility or reliability standard, and causes the model to become less stable. He stated that in the Ontario market he would use half-year data because the size of the market justifies it but in Newfoundland and Labrador, because of the relatively small market size, the effect of using half-year data is to add distortion and randomness in the way the experience unfolds. (Transcript, Dec. 12, p.10, ln.6 - 11)

Ms. Elliot believes that the use of half-year data adds a degree of precision to the trend analysis and permits the data to be scrutinized more closely to determine if aberrations have occurred that should be considered for the purpose of projecting future trends. She confirmed, however, that the use of half-year data does not in and of itself have an effect on the actual findings for the annual trend rates.

The Consumer Advocate supported the use of half-year data and suggested that the Board must decide if the half-year data permits a more in-depth and precise analysis thus producing a more responsive and accurate projection of the trend.

The Board is satisfied that the use of half-year data in this relatively small market would raise the issue of uncertainty in the projected results and have little impact on the private passenger rates proposed by the applicant.

**The Board will accept the use of annual data.**

#### **3.4.9 Private Passenger Comprehensive Trend Frequency**

The flat frequency trend for comprehensive coverage as determined by Mr. Pelly and depicted in Exhibit BGP #3 - 24 results from his judgment that the generally downward frequency trend which is evident for the period 1990 to 1996 will not continue to decline indefinitely. He points out that the trend frequency is essentially flat from 1996 to 2001 and that this suggests a bottom to the earlier declining trend. As argued by Facility Counsel, Mr. Pelly could not fathom continuing a projection of declining frequencies beyond historical levels, lower than ever recorded in the history of this coverage, when the recent six years discloses a general flatness.

Ms. Elliot suggests that Mr. Pelly's approach is unreasonable and she supports the regression analysis based on the period 1990 to 2001 which indicates a negative trend for the future period despite the relatively flat trend resulting from an analysis of the period 1996 to 2001.

The Consumer Advocate argued Mr. Pelly's judgmental selection of a flat frequency trend is unsupported by the evidence and makes no sense, intuitively. He submits that on the evidence the Board should not endorse this selection decision as it completely ignores the data and results in an increase in rates.

The Board believes that applying actuarial judgment to historical trend analysis requires something more than the use of the statistics, regressions and projections based purely on the data. The role of the actuary is broader and when attempting to establish rates for the future requires the data to be interpreted with a degree of common sense and a keen awareness of present and future economic and social events.

**The Board will accept Mr. Pelly's selection of a flat frequency trend as reasonable in this instance.**

#### **3.4.10 Private Passenger Unallocated Loss Adjustment Expense**

In respect of the unallocated loss adjustment expense (ULAE) factor of 1.093 used by Mr. Pelly it is noted that a more current factor became available prior to the start of the hearing. The Board is not convinced that the new factor of 1.082 indicates a sufficient difference to require the re-working of the relevant calculations. The Board believes that the data available to the applicant at the time the application was prepared is better left intact in respect of cut-off dates unless a significant adjustment would result from its use. Data becomes updated at various times during the year and the Board, for the purposes of this proceeding, does not think it to be efficient to

continue to incorporate more current data, the result of which may impede the process to the point that it becomes unfair to all of the parties and imposes an unreasonable delay in the process.

**The Board will accept the Unallocated Loss Adjustment Expense factor for private passenger coverages used by the applicant and based on the data available at the time the application was filed.**

#### **3.4.11 Private Passenger All Perils and Deductibles**

Facility sought approval to:

- (a) change the all perils premium calculation for private passenger to be 100% of the collision premium plus 100% of the comprehensive premium; and
- (b) to change the minimum private passenger deductibles to \$250 for collision and \$100 for comprehensive coverage, to be consistent with industry practice.

The Consumer Advocate recommended the approval of these proposals.

**The Board will accept Facility's proposals to calculate the private passenger all perils premium to be 100% of the collision premium plus 100% of the comprehensive premium; and the change to set the minimum private passenger deductibles to \$250 for collision and \$100 for comprehensive coverage.**

### **3.4.12 Private Passenger Credibility Standard**

Mr. Pelly, in answer to a question from the Consumer Advocate focusing on credibility and whether or not to analyze bodily injury and property damage experience on a separate or combined basis, acknowledged that the separate analysis employed by Ms. Elliot has merit. For the purposes of this application, however, the two were combined. Mr. Pelly cautioned that to change to a separate analysis would require re-visiting the full credibility standard and re-assessing the inherent riskiness involved. He maintained that in order to split the third party liability into two factors, i.e. bodily injury and property damage, would require the building up, over time, of some of the values that are used for the balance of credibility. (Transcript, Dec. 13, p.30, ln 50 - 67). He agreed to study the use of a bifurcated approach as recommended by Ms. Elliot.

**The Board will accept a bifurcated approach in determining a credibility standard for bodily injury and property damage data but will not require its use in the present application. In preparing future rate revisions, Facility will be required to separate the bodily injury and property damage data for the purposes of calculating the credibility standard.**

### **3.4.13 Private Passenger CLEAR (Canadian Loss Experience Automobile Rating)**

CLEAR is the rating system currently used by many insurers to rate own damages coverages of collision, comprehensive and specified perils as well as accident benefits. It replaces the MSRP (Manufacturer's Suggested Retail Price) system which only considered the new vehicle purchase price as the determining criteria for rate group assignment. CLEAR considers a number of

factors such as new vehicle price, damageability and susceptibility to theft to name a few in determining the appropriate rate group category. Under CLEAR a vehicle can have one rate group designation for collision and a different one for comprehensive or specified perils.

Facility proposes to implement CLEAR on a combined rate group basis as promulgated by the Vehicle Information Centre of Canada (VICC), with one rate group assignment per vehicle applicable to collision, comprehensive and specified perils coverages. Accident benefits will not be subject to rating by rate group.

In preparing the filing Facility used the services of VICC to assess the policyholder impact of the changes, based on the December 2000 policy in-force files prepared by the Newfoundland and Labrador servicing carriers. Based on these in-force files, VICC's dislocation analysis determined the distribution across the vehicle population of the magnitude of the premium changes resulting from a revenue-neutral implementation of combined CLEAR as described above. The revenue-neutral objective means that, overall, the individual premium increases resulting from this change approximately offsets the individual premium decreases, all other things being equal. Based on this analysis no steps were deemed necessary by Facility to mitigate excessive policy holder dislocation, and accordingly, Facility proposed full implementation with no capping or phase-in procedures.

Off-balance factors were provided by VICC to apply to the current system's physical damage base premiums to restate them to a combined CLEAR basis while accounting for the rate level impact of the change to VICC CLEAR rate group differentials, all in a manner consistent with

the revenue-neutral objective. For this purpose, the off-balance factor for comprehensive is assumed to apply to specified perils.

CLEAR has been approved for use by Facility in all other jurisdictions in Canada and has been adopted for use in the regular market in Newfoundland and Labrador. The industry in some jurisdictions has not carried out full implementation.

Ms. Elliot found the proposed introduction of CLEAR rate groups by Facility to be reasonable. However, she recommended a more current in-force file, the imposition of caps and a phase-in of the proposed changes. Mr. Pelly disagreed with these proposals stating that the cost would outweigh the benefits and that the number of vehicles subject to extreme dislocation would only approximate 25, or one-third of one percent of the Facility market.

Mr. Anthony was of the view that CLEAR was a very fair mechanism and since it did not apply to third party liability coverage the impact on the Facility market would be low.

The Consumer Advocate recommended that the implementation of CLEAR be subject to the completion of a more recent policy in-force file.

The Board believes that implementation of CLEAR will result in standardization of practices and procedures as well as statistical information gathering for the Facility market. The arguments of the Consumer Advocate to complete a more current in-force file and Ms. Elliot to impose caps and phase in the implementation of CLEAR are not persuasive in the circumstances as the Board

finds both suggestions would have little significant benefit for the consumer and would impose unnecessary costs.

**The Board will accept Facility's proposal to implement CLEAR.**

#### **3.4.14 Clean Driver Discount**

Facility seeks approval for an accident/conviction free discount (Clean Driver Discount), which discount will apply to Private Passenger Vehicles only. The proposed discount is 10% and is available where:

- 1) The regular or frequent driver of the vehicle has had no convictions in the preceding thirty-six months. If this driver has had either a minor, major, or serious conviction he or she will not be eligible for this discount; and
- 2) Where the vehicle has not been assigned any at fault accident in the preceding 60 months.

Facility has proposed the Clean Driver Discount together with the change to the Accident/Conviction Surcharge schedule. Mr. Pelly testified that this package is intended to influence driver behaviour and will bring uniformity across all the jurisdictions where Facility operates. Facility has made or will make application to implement the same changes across all jurisdictions. The Discount has been approved in Ontario and New Brunswick, however, in New Brunswick it was approved at 15% rather than the 10% sought by Facility.

Facility admits that this discount is not actuarially justified but rather is a judgmental proposal which is intended to influence driver behaviour. While the Clean Driver Discount is not actuarially justified it has been subjected to off balance factors to ensure that it is revenue

neutral. That is, the premium reductions which will result from the introduction of the discount will be recovered by other changes to rates, including the increase in rates for those who would have been subject to the amended Accident Conviction Surcharge. Since the two proposals have been presented as a revenue neutral package any changes to the proposed Clean Driver Discount without other changes may have an impact on the overall revenue of Facility.

Both Facility and the Consumer Advocate argued that the introduction of a Clean Driver Discount may have behaviour modification effects. The Board believes that good driving should be encouraged and poor driving discouraged. However, the Board does not accept the submissions of either the Consumer Advocate or Facility with respect to the amount of the discount.

The Consumer Advocate suggests that the Clean Driver Discount should be set at five percent rather than the ten percent proposed by Facility. Facility has sought an increase in rates based on the anticipated loss costs. However, it may be argued that good drivers are not contributing proportionally to these increasing loss costs and therefore should not be subject to the same premium changes. The Board finds that a discount of ten percent is insufficient to recognize this correlation and will therefore establish a Clean Driver Discount of 20%. The Board believes that a 20% Clean Driver Discount will further encourage good driving habits.

The Board acknowledges that one of the objectives of Facility is to have uniformity across jurisdictions. However, the Board notes that the New Brunswick Board has recently required that

Facility implement a discount of 15% while Ontario approved a 10% discount. Therefore Facility must deal with the administration associated with a lack of uniformity in discounts in any event

The Board acknowledges a larger Clean Driver Discount will result in lower premiums than has been estimated for those that are eligible for the discount. This may cause Facility to collect less revenue than was estimated. However, the Board notes that evidence presented on rate level impacts was limited to a sample distribution taken from only one servicing carrier's portfolio of Facility risks.

Based on the evidence the Board is not satisfied that the rate level impacts would be significant and therefore will not require further rate adjustments to reflect the 20 percent Clean Driver Discount. However, in Facility's next filing any proposed changes to discounts or surcharges will be required to be supported by particulars of the premium effects.

**The Board will accept a Clean Driver Discount but will fix it at 20% subject to the eligibility criteria set out in the application.**

#### **3.4.15 Private Passenger Class and Driving Record Differentials**

The differentials proposed by the Applicant to establish relationships between the various classes is intended to address the problem of regular market rates becoming competitive with Facility rates. Mr. Pelly stated that the new differentials will allow for a maximum of plus or minus 5 % as an initial indication for all mature classes and for all driving records except for younger driver classes which are proposed to be capped at plus or minus 7.5%, subject to further refinement.

Ms. Elliot found the method adopted by Facility to implement this change to be reasonable and the Consumer Advocate recommended its approval.

**The Board will accept the private passenger class and driving record differentials as proposed by the Applicant.**

### **3.4.16 Commercial General**

The commercial component of Facility represents 5.2 % of the total Facility market segment.

The

total on-level premiums for accident year 2001 was \$12, 023,000 of which \$623,000 was for commercial vehicles. The rate increase proposed by Facility to the commercial premium is 48.3 %, or \$301,000. The Board's actuary recommended an increase of \$191,000, or 30.7 %, a difference of \$110,000. A summary of the rate revisions by category is attached as Schedule 1. As with the private passenger rate increases, there is a wide difference of opinion between the two actuaries with respect to the appropriate level of commercial rate increase required for Facility for the period commencing February 1, 2003. Both actuaries relied upon the data provided by the IBC and while the data was not audited it was found by both to be reasonable.

The differences in the approaches taken by the two actuaries within the commercial segment are mainly in respect of their impact on loss trend rates. It is noted that because of the relatively small on-level premium in the commercial segment of the Facility market the total value of all of the differences are less than the value associated with even the most minor difference in the private passenger segment.

### **3.4.17 Commercial Loss Development Factors**

In his evidence, Mr. Pelly, on behalf of Facility, provided a number of charts to illustrate his analysis of the loss development factors used to project commercial rates. The selections and exclusions adopted by him appear to be logical and reasonable in the circumstances. Ms. Elliot had a difference of opinion regarding the outliers excluded by Mr. Pelly but maintained her position that she was not prepared to exclude outliers from her development of loss development factors.

The exclusion of outliers for the purpose of loss development is at the discretion of the actuary and is an accepted approach in actuarial practice based on the premise that data which is clearly unrepresentative of past experience should not be relied upon to project future loss costs.

**The Board will accept Mr. Pelly's analysis of the commercial loss development factors as fair and representative of future claims costs.**

### **3.4.18 Commercial Trend Selection**

Following the development of historical loss costs by accident year to their anticipated ultimate value a trend factor is applied to determine how costs are likely to change in the future policy period. There are a number of issues to be determined in the calculation of loss trend.

### **3.4.19 Commercial Annual and Half-Year Data and Seasonality**

A major difference between the two approaches arises as a result of the use of annual data by Mr. Pelly and his opinion, based on his regression analysis, that the winter of 2000 - 2001 was not unusual. Ms. Elliot disagreed, and testified that the winter of 2000 - 2001 produced inflated statistics and using half-year data demonstrates the implication of seasonality resulting in her exclusion of that experience from her analysis. She did not, however, carry forward her exclusions into the trend analysis for other commercial coverages including third party liability physical damage, accident benefits or collision coverages.

Mr. Pelly stated that there was a lack of support for the theory that the winter of 2000 - 2001 was unusual since it did not impact in a similar way on the private passenger statistics and, Ms. Elliot did not recommend an adjustment in the private passenger trend to reflect that fact.

Furthermore, Facility argued that since the evidence of Sgt. John Hill did not include any separate analysis of accidents involving private passenger and commercial vehicles during that period the impact on the commercial vehicle segment could not be confirmed.

It was also argued by Facility that loss costs, when analyzed in half-year components, did not match the half year periods when driving conditions are most severe.

The Consumer Advocate argued that the Board should accept the approach used by Ms. Elliot and exclude the half year data points she recommended based on the winter of 2000 - 2001 being the worst in history for this area.

The Board has rejected the use of half-yearly data in respect of private passenger trend analysis for the reasons put forward by Mr. Pelly in that it raises the issue of uncertainty in this relatively small market and adds randomness and distortion to the data. For the same reasons the use of half-yearly data in the commercial trend analysis is rejected.

**The Board will accept the analysis and results based on the use of the annual data obtained by Mr. Pelly in establishing the projections applicable to the calculation of rates for commercial bodily injury, property damage and collision.**

#### **3.4.20 Commercial Flat Frequency Trend**

In his analysis of commercial property damage and collision Mr. Pelly chose to adopt a flat frequency trend based on a pattern shift he recognized occurring in the recent 6 and 8 year periods, respectively. It was his judgment that this was an indication that different trends were developing and the earlier downward trends in both models had bottomed out. He also testified that his regression model actually suggested an increasing frequency for collision but he was not ready to embrace the forecasting of an increase.

As in the section dealing with private passenger, the Board agrees that the recent 6 to 8 year history indicates a cessation of the earlier downward trend.

**The Board will accept the flat frequency trend adopted by Mr. Pelly to project commercial property damage and collision rates.**

**3.4.21 Commercial Unallocated Loss Adjustment Expense**

The difference of opinion related to this particular expense is in respect of the more current data becoming available after the Facility application was filed. For the same reasons as contained in the private passenger section of this order the Board does not intend to require the applicant to use the updated factor.

**The Board will accept the Unallocated Loss Adjustment Expense factor for commercial coverages used by the applicant and based on the data available at the time the application was filed.**

**3.4.22 Commercial Uninsured Automobile Coverage**

The evidence presented by Mr. Pelly in support of the increased rate of \$19 for this coverage indicated that he relied on the New Brunswick experience since the Newfoundland and Labrador experience was inadequate and unstable. The Consumer Advocate opposed the rate increase for this coverage and suggested the Board should not set the rate in excess of rate level need.

The Board in past benchmarks has used alternate sources of data, in particular in relation to changes to accident benefits coverage, when Newfoundland data has been insufficient or does not adequately reflect new benefits payments. The use of New Brunswick data therefore, in respect to the commercial uninsured motorist coverage, is acceptable until the Newfoundland data is sufficient to stand on its own or to be used on a weighted basis with the New Brunswick data.

**The Board will accept the rate of \$19 for commercial uninsured automobile coverage.**

**3.4.23 Commercial Specified Perils**

The Applicant proposed that specified perils base premiums be set by reference to the proposed comprehensive base premiums. There were no contrary viewpoints expressed by other parties.

**The Board will accept the establishment of the specified perils base premiums by reference to the proposed comprehensive base premiums.**

**3.4.24 Commercial All Perils**

Facility proposes to revise the all perils premium calculation to be 100 % of the collision premium and 100 % of the comprehensive premium. The current proportions are 100 % of the collision premium and 95 % of the comprehensive premium. Ms. Elliot found this proposal to be reasonable and the Consumer Advocate did not oppose its approval.

**The Board will accept the Applicant's proposal to revise the commercial all perils premium calculation to be 100 % of the collision premium and 100 % of the comprehensive premium.**

**3.4.25 Commercial Specified Perils Rate Group Differentials**

Facility proposes to adopt comprehensive rate group differential factors for specified perils to prevent the specified perils premiums from growing larger than the comprehensive premiums at the higher rate group levels. The Consumer Advocate recommended approval of the proposal.

**The Board will accept Facility's proposal to adopt the commercial comprehensive rate group differential factors for commercial specified perils.**

#### **3.4.26 Commercial Deductibles**

Facility proposed to increase the minimum deductible to \$100 for comprehensive and specified perils and to change the base deductible to \$500 for collision, comprehensive and specified perils. Mr. Pelly indicated that this change would have no impact on the rates and was merely a housekeeping change. The Consumer Advocate recommended approval of this change.

**The Board will accept the change of the minimum deductible to \$100 for commercial comprehensive and specified perils and to change the base deductible to \$500 for commercial collision, comprehensive and specified perils.**

#### **3.4.27 Commercial Accident Benefits Coverage**

Commercial accident benefits coverage is rated at the same level across all three rating territories. Mr. Pelly stated, however, that, subject to the regular market's adoption of a territorial rate for accident benefits there is a strong indication that the next Facility application for rate revisions will address the accident benefits on a territorial basis with a capping mechanism to mitigate the dislocation that may occur. Accident benefits coverage is not mandatory in the province and represents a very small portion of the written premium.

**The Board will accept the revisions to commercial accident benefits coverages as proposed.**

#### **4.0 Implementation Issues**

Both Mr. Pelly and Mr. Simpson testified during the hearing that should the Board not accept the filing in its entirety as submitted, Facility will require 105 days from the date of the order of the Board to implement any revisions to the rates directed by the Board.

In addition, Facility asked that the rates be recast for trend to reflect the delay in implementation of new rates beyond the original date contemplated in the filing. Ms. Elliot acknowledged that the recasting of the rates would be reasonable in the circumstances. The Consumer Advocate, in his argument, agreed that any rate approval should reflect the impact of an implementation date later than originally contemplated by the applicant.

It is anticipated that the earliest possible effective date which can now be achieved will be August 1, 2003, bearing in mind that the revisions to the filing required herein will need to be reviewed by the Board's actuarial consultants prior to final approval.

**The Board will allow Facility to recast the proposed rates to reflect the impact of the earliest possible implementation date it can reasonably achieve, having regard for the additional time that will be necessary to have the revisions, arising from this Order, reviewed by the Board's Consulting Actuary and a subsequent Order issued.**

#### **4.1      Costs**

The Consumer Advocate was appointed by the Lieutenant Governor in Council on January 6, 2003. While the appointment was said to take effect on November 13, 2002, the amendment to the Automobile Insurance Act under which the appointment was made was not passed until December 16, 2003. Therefore it may be argued that the Consumer Advocate was not officially appointed until December 16, 2003.

Counsel for Facility Association argued that because the appointment was not filed pursuant to the *Statutes and Subordinate Legislation Act* RSN 1990, c.S-27 it was not a valid appointment. Irrespective of the effective date of the appointment of the Consumer Advocate pursuant to the *Automobile Insurance Act*, Mr. O'Flaherty was granted intervenor status in this matter on November 22, 2002 with the consent of Facility as set out in A.I. No. 30 (2002-2003). Therefore the Board finds that he was a party to the action and therefore is entitled to seek an award of costs.

The Board has the discretion under subsection 90(1) of the Public Utilities Act to award costs to any party. The Consumer Advocate has asked the Board for an order of costs. The Board finds that the Consumer Advocate's participation in this hearing was valuable and contributed to a full examination of the issues and therefore that he is entitled to reimbursement of his costs.

**The Board will make an award of costs to the Consumer Advocate, excluding those fees and disbursements which have been or are subject to reimbursement pursuant to the amendments to the *Automobile Insurance Act*.**

**The Board will fix an amount for those costs upon being presented with an invoice of the fees and disbursements of the Consumer Advocate, excluding the amount that has been claimed or paid pursuant to the terms of the *Automobile Insurance Act*.**

**In addition, the Board, pursuant to section 90(2) of the *Public Utilities Act*, will require Facility to pay all the expenses of the Board arising from or in any way connected with this matter, including all the fees and expenses of the Consumer Advocate incurred pursuant to the *Automobile Insurance Act*.**

## **5.0      The Order**

### **IT IS THEREFORE ORDERED THAT:**

- 1. Facility shall file for the Board's review, revised private passenger rates consistent with its application, incorporating the following:**
  - a. The loss development factors used in deriving the rates for private passenger bodily injury and accident benefits shall be established:**
    - i without the exclusion of any data points;**
    - ii using the proposed five year arithmetic average.**
  
  - b. The loss trends used in deriving the rates for private passenger coverages shall be calculated as proposed by Facility in its application using:**
    - i the number of years of historical data included in the regression;**
    - ii annual accident year data rather than accident half-year data;**
    - iii the unemployment variable in applying the regression model for collision and property damage tort-frequency;**
    - iv a frequency trend of zero for comprehensive .**
  
  - (c) The unallocated loss adjustment expense factor proposed by Facility in its application shall be used in determining the rates.**
  
  - d. The all perils premium shall equal 100% of the collision premium plus 100% of the comprehensive premium as proposed.**

- e. **Minimum deductibles shall be \$250 for collision and \$100 for comprehensive coverage, as proposed.**
  - f. **CLEAR rate groups shall be introduced on a single combined rate group basis applicable to collision, comprehensive, and specified perils as proposed.**
  - g. **A Clean Driver Discount of twenty percent ( 20%) shall be offered subject to the proposed eligibility criteria.**
  - h. **The class and driving record differentials shall be implemented as proposed.**
2. **All other private passenger rates not affected by the foregoing are to be resubmitted as originally filed**
3. **Facility shall file for the Board's review, commercial rates consistent with its application, based on the following:**
- a. **The loss development factors used in deriving the rates shall be established as proposed by Facility;**
  - b. **The loss trends used in deriving the rates shall be calculated as proposed by Facility;**

- c. **The unallocated loss adjustment expense factor proposed by Facility in its application shall be used in determining the rates;**
- d. **The rate for uninsured automobile at nineteen dollars (\$19.00), is accepted as proposed by Facility;**
- e. **Specified perils base premiums shall be established by reference to the proposed commercial comprehensive base premiums, as proposed by Facility;**
- f. **All perils premium calculation shall be revised to equal the sum of 100% of the collision premium plus 100 % of the comprehensive premium, as proposed by Facility;**
- g. **Comprehensive rate group differential factors shall be adopted for specified perils, as proposed;**
- h. **The minimum deductible for comprehensive and specified perils shall be one hundred dollars (\$100.00), as proposed by Facility;**
- i. **The base deductible for collision, comprehensive and specified perils shall be changed to five hundred dollars (\$500.00), as proposed by Facility;**
- j. **The accident benefits coverages shall be revised as proposed by Facility.**

4. **The trend factors for all coverages shall be recast to reflect the impact of the later implementation date on the trend factors for all coverages.**
5. **The implementation date of the rates shall be no earlier than August 1, 2003.**
6. **The proposed revisions to the Accident/Conviction Surcharge Schedule for all coverages are denied.**
7. **Upon the implementation of the revised rates flowing from this Order, Facility shall cause to be collected information as detailed in Schedule 3 to this Order, which Schedule may be amended by the Board from time to time.**
8. **In its next rate revision, Facility shall:**
  - i. **provide financial statements which show its internal administrative revenues and expenses independent of the results of its activities as manager of its members pooled funds;**
  - ii. **separate the bodily injury and property damage experience data for the purposes of calculating its rate level need.**
9. **Facility shall pay the costs of the Consumer Advocate in an amount to be fixed by the Board, which will exclude those fees and disbursements which have been or are subject to being reimbursed pursuant to the amendments to the *Automobile Insurance Act*.**

**10. The Consumer Advocate shall provide the Board with a detailed statement of his costs by the 30<sup>th</sup> of April, 2003.**

**11. Facility shall pay all the expenses of the Board arising from or in any way connected with this matter, including all the fees and expenses of the Consumer Advocate incurred pursuant to the *Automobile Insurance Act*.**

Dated at St. John's, Newfoundland and Labrador, this 9th. day of April 2003.

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G. Fred Saunders,  
Presiding Chair

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Gerard Martin, Q.C.,  
Commissioner.

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Don R. Powell,  
Commissioner.

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G. Cheryl Blundon,  
Board Secretary.