NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

AN ORDER OF THE BOARD

NO. A.I. 3(2019)

IN THE MATTER OF the *Automobile Insurance Act*, RSNL 1990, c. A-22, (the "*Act*"), as amended and regulations thereunder; and

IN THE MATTER OF an application by Facility Association for approval of revised rates for its Newfoundland and Labrador Public Vehicles – Taxis and Limousines class of business.

1. The Application

Facility Association ("Facility"), as operator of the residual market mechanism for automobile insurance in the Province, filed a Category 2 application on July 30, 2018 seeking approval of increased rates for its Newfoundland and Labrador Public Vehicles – Taxis and Limousines ("Taxis") class of business (the "Application"). The Application proposes overall rate increases for Third Party Liability, Accident Benefits, Uninsured Automobile and Collision coverages, to be effective 100 days post approval and no earlier than March 1, 2019, as follows:

Proposed Taxi Rate Increases[1]				
	Third Party Liability	**Accident Benefits**	**Uninsured Automobile**	**Collision**
Proposed % Increase	+10.5%	+7.1%	+15.2%	+5.9%
Proposed Average $ Increase	+$662	+$37	+$38	+$49

Rates for Comprehensive and Specified Perils coverages are proposed to decrease by 0.1% and 6.2%, respectively. Facility estimates that its Application proposals, if approved, will result in an increase of 10.2% in its overall rate level in the Province for all coverages combined, and a proposed average premium of $7,965 per vehicle.[2]

This Application is Facility's sixth request for an increase in rates for its Taxis class of business since 2013. As a result of the previous applications, Facility's rates for Taxis increased by an

[1] Facility's Actuarial Memorandum, Exhibit A-1. Individual policyholder increases will vary depending on coverage level and driving record.
[2] Facility's Actuarial Memorandum, Exhibit C-1.

average of 50.1% on August 1, 2013, 19.3% on September 1, 2015, 28.9% on June 1, 2016, 25.7% on March 1, 2017 and 18.6% on March 1, 2018.[3] Prior to 2013 rates for Taxis had not changed since 1993 as Facility did not file any applications for rate changes in the intervening 20-year period.

2. Procedural Matters

The Application was referred to the Board's actuarial consultants, Oliver Wyman Limited ("Oliver Wyman"), for review.

On August 8, 2018 Oliver Wyman filed questions on Facility's actuarial analysis and Facility filed responses on August 24, 2018. On September 7, 2018 Oliver Wyman filed additional questions in relation to the Application and Facility filed responses on September 18, 2018.

On October 19, 2018 the Board extended the 90-day review timeline.

On October 25, 2018 Oliver Wyman filed a report (the "Oliver Wyman Report") outlining its review of the actuarial justification provided in the Application. On November 9, 2018 Facility requested an extension to file comments on the Oliver Wyman Report. Comments in response to the Oliver Wyman Report were filed by Facility on November 21, 2018. Oliver Wyman filed a supplemental report on November 29, 2018. Commentary in response to Oliver Wyman's supplemental report was filed by Facility on December 10, 2018 and a reply was filed by Oliver Wyman on January 3, 2019. A request for confirmation of indicated rate changes was sent to Facility from Oliver Wyman on January 30, 2019.

A Notice of Application was published in newspapers throughout the Province starting February 9, 2019 inviting interested parties wishing to comment on the Application to contact the Board by February 20, 2019. No submissions were received.

3. Review of Application Proposals

In the Application Facility presents its rate level need using three sets of assumptions for cost of capital and return on investment ("ROI").[4] Facility's overall rate indications and proposed changes based on 0% cost of capital and 2.8% ROI are shown below:[5]

---

[3] Order Nos. A.I. 9(2013), A.I. 11(2015), A.I. 15(2015), A.I. 3(2016), A.I. 5(2016), A.I. 14(2016), A.I. 18(2016), and A.I. 14(2017).

[4] Facility presents three rate level indications based on: i) 12% cost of capital and 1.79% ROI; ii) 0% cost of capital and 1.79% ROI; and, iii) 0% cost of capital and 2.80% ROI. The overall rate level indication for each of these scenarios is +26.3%, +13.5% and +10.2%, respectively.

[5] Facility's Actuarial Memorandum, Exhibit C-1.

Coverage	Overall Rate Indication (0% cost of capital and 2.8% ROI)	Overall Proposed Rate Change
Third Party Liability	+10.5%	+10.5%
Accident Benefits	+7.1%	+7.1%
Uninsured Automobile	+15.2%	+15.2%
Collision	+5.9%	+5.9%
Comprehensive	-0.1%	-0.1%
Specified Perils	-6.2%	-6.2%
Total	**+10.2%**	**+10.2%**

Facility proposes overall rate level changes by coverage that are the same as its indications using 0% cost of capital and 2.8% ROI.

Oliver Wyman reviewed Facility's proposals and associated ratemaking procedure and provided commentary in relation to Facility's: i) selection of ultimate losses; ii) complement of credibility; iii) expense provision; iv) treatment of finance fee revenues; and v) adjustment for the HST rate change. These issues, along with the Board's findings on each, are discussed in the following sections.

4. Board Findings

The Board is cognizant that there are a wide range of possible outcomes in any prospective ratemaking exercise. The Board must be satisfied that the proposed rate changes are supported based on the information filed and are not too high in the circumstances. In making this determination the Board looks to the professional judgement of the actuaries, as well as the support and explanation for their respective positions.

The Board has reviewed the record of the proceeding, including Facility's Actuarial Memorandum, Oliver Wyman's reports on its review of the Application, and Facility's responses to the Oliver Wyman Report and the information requests. The issues to be addressed are: i) selection of ultimate losses; ii) complement of credibility; iii) expense provision; iv) finance fee revenues; and v) HST adjustment.

4.1 Selection of Ultimate Losses

Facility's selected ultimate losses by accident year and coverage are its Appointed Actuary's selected Newfoundland and Labrador Non-Private Passenger Vehicle losses by accident half-year and coverage, evaluated as of December 31, 2017. These Non-Private Passenger Vehicle losses are not exclusive to taxi claim experience.

Oliver Wyman noted that Facility's Appointed Actuary considers several loss estimation methods, including the Link Ratio Method, the Expected Loss Ratio Method, the Bornhuetter-Ferguson ("B-F") Method, and the Weighted Method. After consideration of the result, Facility's Appointed Actuary selected a "best estimate", which for this Application was generally the result of the Link Ratio Method for older accident years and either the B-F Method or the Weighted Method for more recent accident years. Oliver Wyman acknowledged that Facility's Appointed Actuary has greater insight into Facility's claim experience and claim reserving practices, but noted that a considerable amount of judgement is exercised when making the selection of ultimate losses.

Oliver Wyman also noted that, for Bodily Injury, Facility's Appointed Actuary's estimates of ultimate loss ratios for 2017-1 under the Link Ratio, the B-F and the Weighted Methods were 56.4%, 59.2% and 77.9% respectively, and the Appointed Actuary's selection was 77.9%. Likewise, for 2017-2, Facility's Appointed Actuary's estimates of ultimate loss ratios under the Link Ratio, the B-F and the Weighted Methods were 50.4%, 60.4% and 75.0%, respectively, and the Appointed Actuary's selection was 75.0%. According to Oliver Wyman Facility's selection of the highest of each of these results led to a higher rate indication than if Facility had selected the results of a different method. The Oliver Wyman Report stated that, if the Appointed Actuary had selected loss ratios under the B-F Method for Bodily Injury and Accident Benefits, and with no other changes in assumptions, Facility's overall rate level indication would reduce from +10.2% to +6.9%.

Oliver Wyman submitted that the approach taken by Facility for its selection of ultimate losses in this Application was the same as that taken in Facility's prior taxi rate application, and given the limited taxi experience Oliver Wyman found this approach to be reasonable in the prior rate application. For this Application, Oliver Wyman noted that Facility's explanation for the increase in Third Party Liability loss costs per taxi from $4,771 in Accident Year 2016 to $6,611 in Accident Year 2017 is attributed to its Appointed Actuary's selection of the Weighted Method. Oliver Wyman also noted that Facility's Appointed Actuary gives little weight to the actual loss experience that has emerged with its selection of the Weighted Method. Oliver Wyman reiterated that there is a range of reasonable loss selections that Facility's Appointed Actuary could have made, and the impact of the alternate selections on the rate level indications could be material. This range of reasonable loss selections and the Appointed Actuary's use of Facility Non-Private Passenger Vehicle claim and loss ratio experience adds to the uncertainty of Facility's estimated rate level need. In Oliver Wyman's opinion, the B-F Method instead of the Weighted Method provides a reasonable estimate of the ultimate loss amount in a ratemaking context.

Facility submitted the following with regards to its selection of ultimate losses:

> …while it may be factually correct that the sections for accident halves 2017-1 and 2017-2 inclusive were the higher of the Weighted Method and B-F method estimates, this was due to thoughtful consideration of each accident half independently, rather than an explicit approach of selecting the higher of the two estimates.
>
> We believe our entire process, our selected models, and the associated results are reasonable and should be considered in their entirety.[6]

Facility also stated that:

> The "Weighted Method" is a percentile weight between two valuation methods ultimates (Incurred Chain Ladder method and Expected Loss Ratio method) based on the actuary's judgement. The Bornhuetter-Ferguson (B-F) proposed OW selections is also a percentile

[6] Facility Association Response to Oliver Wyman Report, November 21, 2018, page 10.

> weight between two valuation ultimates (Incurred Chain Ladder method and Expected Loss Ratio method) based on the actuary's judgement of chain ladder (link-ratio) selected development. It is our experience and understanding that using percentile weight between valuation methodologies is not an uncommon Industry approach in valuation or rate filings in Canada…(that is, not uncommon for a valuation actuary to select an ultimate as a weighted average of two or more other valuation methodologies).[7]

In response to Oliver Wyman's finding that the B-F Method, rather than the Weighted Method used by Facility, provides a reasonable estimate of the ultimate loss amounts in a ratemaking context Facility noted that, in its view, there is no contextual difference in Facility's Appointed Actuary's work and how that work should be interpreted or altered in relation to a rate filing. In Facility's view, it would be unreasonable to present an alternative ultimate estimate for valuation purposes and pricing reviews in relation to the same accident period. Facility advised it has no intention to do so and believes that the Board should accept Facility's estimate as best estimates for this Application.[8]

Facility also submitted that its approach to the selection of ultimate losses allows its Appointed Actuary to explicitly control the timing of process variance estimation recognition and Facility's Appointed Actuary believes the approach is reasonable and preferable for the development ages to which it was generally applied.

Oliver Wyman provided additional commentary in relation to the selection of ultimate losses, noting the following: i) the weight in the B-F Method effectively also considers parameter risk, i.e. the risk that the expected amount is incorrect; ii) the B-F Method is designed to calculate IBNR with minimal regard to process risk which is generally expected to be diversified away in the approach used to determine a reporting pattern; iii) the weight is not a function of the chain ladder estimate but rather a function of an assumption within the chain ladder estimate; and, iv) Oliver Wyman does not disagree that the Weighted Method allows Facility's Appointed Actuary to explicitly control the timing of process variance estimation recognition and that is consistent with Oliver Wyman's argument that another actuary reviewing the same data could, and likely would, have a different best estimate.

The Board accepts that the estimation of ultimate losses is a matter of actuarial judgement but notes that these estimates can vary depending on which methodology is used and that the exercise of judgement means that different actuaries may provide different but reasonable "best estimates". The Board notes that the approach taken by Facility for its selection of ultimate losses in this Application was the same as that taken in Facility's prior taxi rate application, and given the limited taxi experience Oliver Wyman found this approach to be reasonable in the prior rate application. In this Application Oliver Wyman acknowledged that Facility's Appointed Actuary has greater insight into Facility's claim experience and claim reserving practices and there is a range of reasonable loss selections that Facility's Appointed Actuary could have made.

---

[7] Facility Association Response to Oliver Wyman Supplemental Report, December 10, 2018, page 5.
[8] Facility Association Response to Oliver Wyman Supplemental Report, December 10, 2018, page 7.

The Board also notes that the data used in this Application includes Facility's Non-Private Passenger Vehicle claim and loss ratio experience which adds further uncertainty with respect to the selection of ultimate losses. Given this uncertainty and the claims and loss experience of taxis it would not be unreasonable for Facility's Appointed Actuary to conclude that the selected ultimate loss amounts in the Application are reasonable. As the selection of ultimate losses could result in a range of "best estimates" based on an actuary's judgement and Oliver Wyman did not provide any support to justify a finding that Facility's proposed selection of ultimate losses are unreasonable, the Board is satisfied that Facility's selection of ultimate losses does not result in rates which are too high in the circumstances.

The Board accepts Facility's proposed selection of ultimate losses.

4.2 Complement of Credibility

Actuaries use credibility procedures to improve estimates by blending together two or more sets of experience. The complement of credibility refers to the availability and value of any other data with which an insurer's experience is credibility weighted. In the Application, Facility applied net trend to the prior credibility weighted loss ratio it selected, adjusted for the approved rate change as the complement of credibility.

Oliver Wyman stated that Facility's approach implicitly adjusts for rate inadequacy that Facility believed resulted from the Board's prior approvals of a much lower rate level change than Facility found was required at the time of the last filings. Oliver Wyman found that removing Facility's adjustment for any perceived rate inadequacy, and with no other changes in assumptions, Facility's overall rate level change is reduced from +10.2% to +5.2%.

Facility suggested that the Board should reconsider its earlier findings in relation to the complement of credibility with the benefit of hindsight, noting that the prior Taxis rate changes approved by the Board have been found to significantly deficient. Facility believes this should be recognized and accounted for.[9]

The Board addressed its concerns in relation to Facility's perceived rate inadequacy adjustment in its complement of credibility in Order Nos. A.I. 11(2015), A.I. 3(2016) and A.I. 4(2017) issued in relation to prior Facility taxi rate applications. In Order No. A.I. 4(2017) the Board stated the following in relation to Facility's perceived rate inadequacy adjustment:

> The underlying Taxis experience data used by Facility to determine its rate level need is based on a small sample and exhibits considerable volatility, which makes it difficult to assess rate adequacy and to actuarially justify proposed increases in rates. It is clear, based on the evidence, that the Taxis experience in the Province has been and continues to be very poor, which suggests that additional filings for rate increases for Taxis may be forthcoming in the short term. However, the Board is not satisfied that a rate inadequacy adjustment is appropriate in the circumstances and, as a result, Facility's adjustment for rate inadequacy is not accepted.[10]

---

[9] Facility Association Response to Oliver Wyman Report, November 21, 2018, page 14.
[10] Order No. A.I. 4(2017), page 10/15-22.

The Board accepts that the net trend approach used by Facility is a reasonable and appropriate methodology used by other actuaries; however, the Board is not satisfied that a rate inadequacy adjustment is appropriate. The Board's role in a prospective rate making process is to ensure rates proposed by Facility are not too high in the circumstances and are actuarially justified.

The Board does not accept Facility's proposed complement of credibility.

4.3 Expense Provision

Facility assumed a total expense provision of 24.52% allocated as follows: (a) variable: 6% standard commissions, 5% premium tax, 1% servicing carrier fee, 0.18% miscellaneous regulatory fees, and 9% servicing carrier operating costs; and, (b) fixed: 1.54% for driving record abstracts and 1.8% for central office expenses.

Oliver Wyman noted that the 6% commission rate is based on an agreement between Facility's Board and its servicing carriers, the 5% premium tax rate is set by the Provincial Government, and the servicing carrier fee of 1% and servicing carrier operating costs of 9% are based on a compensation agreement between Facility's Board and its servicing carriers for processing taxi policies. Oliver Wyman identified concerns with respect to the driving record abstract fees and servicing carrier fees.

Driving Record Abstract Fees

Oliver Wyman noted that the driving record abstract fee increased from $86 in Facility's prior taxi rate application to approximately $123 in this Application. Facility explained that the increase is due to improvements in its allocation and reconciliation process of these costs in each province. Oliver Wyman found the change in process to be reasonable but requested a comparison of these costs in Newfoundland and Labrador to those in Nova Scotia and New Brunswick. The provisions in each province are as follows: $122.98 in Newfoundland and Labrador; $99.77 in Nova Scotia; and, $81.49 in New Brunswick. While the regulated fees are marginally lower in this Province, Facility explained the actual driving record abstract provision included by Facility is higher in Newfoundland and Labrador because the estimate of the number of drivers per taxi in the Province, at 5.0 per vehicle, is higher than that in both Nova Scotia, at 2.6 per vehicle, and New Brunswick, at 1.9 per vehicle.

Facility submitted that its estimate of 5 drivers per taxi is based on a sample. Oliver Wyman requested Facility explain why the estimate for Newfoundland and Labrador is much higher than that in the other Atlantic Provinces; however, Facility was unable to provide insight. Oliver Wyman recommended that this issue be addressed by Facility and, if appropriate, the driving record abstract fee for taxis be modified.

Servicing Carrier Fees

Facility's Servicing Carriers are compensated by Facility according to its approved Plan of Operation which provides for a total fee of 10% of premiums for processing and handling of policies. For Newfoundland and Labrador, the proposed Servicing Carrier fee provision in rates would be $796 based on the proposed average premium of $7,965.

Oliver Wyman identified two concerns with regards to Facility's Servicing Carrier fee provision: i) the 10% provision does not reflect actual expense costs incurred by the Servicing Carriers to perform the service; and, ii) the percentage approach without any cap results in a relatively high cost that is included in the rates compared to Nova Scotia and New Brunswick for the same services.

Facility submitted that Servicing Carriers are acting as an intermediary, commissioned by Facility to perform certain tasks on the behalf of the organization. These Servicing Carriers are compensated via the methodology and levels prescribed in the Plan of Operation. Facility also noted that the Application reflects the actual, legally binding costs, in its expense provision, on behalf its members, who are "joint and severally" responsible for the insurance contract obligations arising through the Facility Association Residual Market.[11]

Facility suggested that there are other options it could have taken in order to be able to underwrite and issue automobile insurance contracts in Newfoundland and Labrador, but these alternatives, in Facility's view, would be substantially more expensive than its current out-sourcing model. Facility stated that its management believes that the current compensation model for Servicing Carriers is appropriate and allows for flexibility where volumes change rapidly.

Facility further noted that Servicing Carriers are for-profit enterprises and should be allowed a non-zero return for the services they provide as the Servicing Carriers incur risks in providing its services. As such, it is appropriate to include their costs as provisions in the rate program consistent with how the Servicing Carriers will actually be paid under the Plan of Operation.

The Board finds that the Servicing Carrier fees are in accordance with Facility's approved Plan of Operation and, while it is unclear that the proposed expense payments to Servicing Carriers accurately reflects the actual costs of writing Taxi business, the Superintendent of Insurance approves the Servicing Carrier fees in the Plan of Operation and Facility is obliged to pay these expenses.

The Board also has general concerns with the driving record abstract fee provision included in the Application; however, the Board accepts this provision in this circumstance as Facility's overall total expense provision in the Application is within the Board's Guideline expense provision of 28%. The Board accepts Facility's total expense provision of 24.52%, subject to the Board's findings regarding the finance fee revenues in the following section.

The Board accepts the Facility's proposed expense provision.

[11] Facility Association Response to Oliver Wyman Report, November 21, 2018, page 22.

4.4 Finance Fee Revenues

Oliver Wyman noted that, in Order No. A.I. 21(2018) issued in relation to Facility's prior private passenger vehicle rate application, Facility was directed to include a provision for the fees that policyholders pay for payment plan options. Facility advised that two of its larger servicing carriers for taxis charge a 3% finance fee and a smaller carrier does not charge a finance fee. Facility does not account for these revenues in determining its rate level need in this Application. According to Oliver Wyman it is appropriate for Facility to be consistent with Order No. A.I. 21(2018) and the Board's decision in relation to finance fee revenues. As Facility is unable to directly estimate the finance fees for taxis, an estimated net fee of 0.75% was tested consistent with that used in its prior private passenger vehicle rate application. Facility calculated that this change, and no other changes in assumptions, reduces the overall rate level indication from +10.2% to +9.1%.

With regards to the finance fee revenues, Facility submitted:

> …we do not provide premium financing – this is provided directly by the Servicing Carriers, who provide the capital to support this service directly, bear all costs, and keep any profits generated. Explicitly, supporting capital and return, premium cash flows, administrative costs, and expected credit losses all related to premium financing are NOT considered in the FA indication.[12]

Facility noted that, if premium financing fee revenue were to be included in the determination of Facility's overall rate indications, adjustments would need to be made to ensure consistency in the revenue, return and capital related to premium financing. These adjustments would include i) incorporation of supporting capital and the return on that capital; ii) adjustments to premium cash flow assumptions to reflect "later" collection of cash; iii) an increase to the administrative costs assumption; and iv) a provision for "bad debt".[13]

In the Board's view finance fee revenues should be reflected in rates since they are revenues collected by insurers in premiums paid monthly. Facility's position is that premiums are collected by the Servicing Carriers and not Facility. While this may be the case insureds in Facility are still paying the finance fees, irrespective of who collects (and retains) these fees. In the interest of fairness and consistency all insureds should receive the benefit of offsetting revenues associated with premium financing plans in setting rates. Without this offset the Board cannot be satisfied that the proposed rates are not too high. In the absence of further supporting information as to the appropriate level of revenue offset to include, the Board accepts Oliver Wyman's assumption of a net finance fee revenue of 0.75% of premiums, consistent with the private passenger vehicle net fee estimate. Future rate applications from Facility should include finance fee revenue with supporting information.

[12] Facility Association Response to Oliver Wyman Report, November 21, 2018, page 25.
[13] Ibid.

The Board does not accept the exclusion of finance fees revenue.

4.5 HST Adjustment

In the Application Facility applied HST adjustment factors of 1.2% for Bodily Injury and Accident Benefits. Oliver Wyman found that the HST adjustment factors of 1.0053 for Bodily Injury and 1.0142 for Accident Benefits, as approved by the Board in Order No. A.I. 28(2018), issued in relation to Facility's private passenger vehicle class of business to be reasonable for taxis. Facility calculated that the use of these HST adjustment factors, and no other changes in assumptions, reduces the overall rate level indication from +10.2% to +9.5%.

Facility submitted that it has a different view from that of Oliver Wyman. According to Facility there will be indirect impacts as the HST impact manifests itself in a one-time increase in inflation that can influence Bodily Injury and Accident Benefits settlement amount. As such, Facility believes its adjustment for HST to be reasonable.

The Board accepts the HST adjustments proposed by Facility for all coverages except Accident Benefits and Bodily Injury. The Board finds that Facility's selections for HST adjustment factors for Accident Benefits and Bodily Injury are inconsistent with Order No. A.I. 28(2018) and may result in rate indications that are too high in the circumstances.

The Board does not accept the HST adjustments for Accident Benefits and Bodily Injury as proposed by Facility.

4.6 Conclusion

The Board has accepted Facility's proposals and assumptions contained in the filing with the exception of: i) complement of credibility; ii) treatment of finance fee revenues; and iii) adjustment for the HST rate change.

Based on the record for this Application the Board accepts that a rate increase for Facility's Taxis class of business appears to be justified, although not at the level proposed by Facility. Facility may file a revised application incorporating the Board's findings in this Decision and Order.

5. Order

IT IS THEREFORE ORDERED THAT:

1. The Application by Facility Association is denied.

2. Facility Association will pay all costs of the Board, including the cost of the actuarial review, arising from this Application.

DATED at St. John's, Newfoundland and Labrador, this 14th day of March, 2019.

Darlene Whalen, P. Eng., FEC
Chair & CEO

John O'Brien, FCPA, FCA, CISA
Commissioner

Cheryl Blundon
Board Secretary