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Cheryl Blundon,
Board Secretary
Board of Commissioners of Public Utilities
P.O. Box 21040
St. John's, Newfoundland and Labrador
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April 25, 2018

Subject: Other Coverages Review – Private Passenger Automobiles

Dear Ms. Blundon:

The Board has asked Oliver, Wyman Limited (Oliver Wyman) to assist in the review of the following segments of Phase II as described in the Terms of Reference[1] provided by the Department of Service NL to the Board for private passenger automobiles.

1) To review the current mandatory Section A (Third Party Liability) limit of $200,000 and the rate implications of increasing the limit.
2) To review the impact of offering direct compensation for physical damage to automobiles (Section C).
3) To review Section D (Uninsured Automobiles) coverage in the Province.
4) To review the relationship of Section B (Accident Benefits) benefits to the settlement of Section A benefits, and whether the Section B coverage should be mandatory.

[1] http://www.pub.nf.ca/insurance/2017AutoInsReview/correspondance/PUB%20Terms%20of%20Reference.8.2017.pdf

In this report, we discuss our findings on these four topics.

The findings that we present in this report are based on the Industry-wide Automobile Statistical Plan private passenger automobile data collected and compiled by the General Insurance Statistical Agency and the database collected by the Insurance Bureau of Canada of recently closed Bodily Injury claims for private passenger automobiles in Newfoundland and Labrador. We refer to this database as the Newfoundland and Labrador 2018 Closed Claim Study (NL 2018 CCS). We provided our summary of the NL 2018 CCS to the Board in our report dated April 19, 2018.

We are available at your convenience to discuss this report.

Sincerely,

Paula L Elliott

Paula Elliott FCAS, FCIA

OTHER COVERAGES REVIEW - PRIVATE PASSENGER AUTOMOBILES

NEWFOUNDLAND AND LABRADOR INSURANCE INDUSTRY

25 APRIL 2018

Contents

1. Introduction and Summary

As described in the Terms of Reference, Phase II, the Province of Newfoundland and Labrador, Department of Service NL, has asked the Board of Commissioners of Public Utilities of Newfoundland and Labrador ("The Board") to review different aspects of the Private Passenger Automobile coverages offered in Newfoundland and Labrador.

The Board has engaged Oliver Wyman to assist with the review of the following components of Phase II:

1) To review the current mandatory Third Party Liability limit of $200,000 and the rate implications of increasing the limit.
2) To review the impact of offering direct compensation for physical damage to automobiles.
3) To review Uninsured Automobiles coverage in the Province.
4) To review the relationship of benefits provided under the Accident Benefits coverage to the settlement of Third Party Liability benefits, and whether the Accident Benefits coverage should be mandatory.

In this report, we provide our key findings, discuss the data we considered, and any key assumptions that we made.

Summary of Key Findings

Third Party Liability Limit:

In Newfoundland and Labrador, 1.36% of all private passenger vehicles (4,416 out of 325,285) were insured at the minimum Third Party Liability (TPL) limit of $200,000 in accident year 2016[2]. The remaining vehicles are insured at higher limits; 98.51% are insured at limits of $500,000[3] and higher.

[2] As provided in the most recent GISA Exhibit AUTO 1010 as of December 31, 2016.

[3] Only 0.13% of the risks are at the $300,000 limit.

However, for those risks insured with the Facility Association (which is the insurer of "last resort"[4]), 13.2% of private passenger vehicles (1,407 out of 10,658) were insured at the minimum TPL limit of $200,000 in 2016.

Therefore, an increase in the minimum TPL limit would mainly affect those risks in the Facility Association.

The relative additional premium to increase from a TPL limit of $200,000 to $500,000 is approximately +11% for Facility Association. Other insurers charge between +11% to +18% of the TPL premium to increase from $200,000 to $500,000.

Direct Compensation Property Damage (DCPD):

DCPD is a coverage that allows a not-at-fault claimant to collect payment for damages to its own vehicle from its own insurer (directly), instead of from the at-fault party's insurer. The coverage is "formed" by splitting the current Property Damage coverage into two components: DCPD and PD-Tort, which we estimate to be split 93%/7%, respectively.

This coverage was introduced in New Brunswick in 2005 and in Nova Scotia in 2013. Conceptually, no new claims costs are added to the system on an Industry-wide basis; rather, claim handling costs related to subrogation between insurers is reduced. There is no data to measure the reduction in claims handling costs[5] with the introduction of DCPD in Nova Scotia or New Brunswick. However, for reasons that are not fully understood, in Nova Scotia there has been some evidence of an increase in the total DCPD and PD-Tort *claims costs* following the introduction of DCPD.

Uninsured Automobile (UA)

The Uninsured Automobile (UA) coverage recovers the cost of the benefits a person would be legally entitled to recover from the owner or driver of another vehicle for Bodily Injury, Death, and Property Damage in the event that the other vehicle is uninsured or unidentified.[6]

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[4] In 2016, based on data provided by GISA, 3.3% of overall Newfoundland and Labrador insured vehicles (10,658 out of 325,285) were insured by the Facility Association.

[5] The long-term benefit of reduced claims handling costs is partially offset by the one-time technical and administrative costs associated with setting up a new coverage.

[6] The exception is that in the event of Property Damage caused by an unidentified automobile, UA will not provide coverage.

The cost of UA claims has been increasing in Newfoundland and Labrador over the last five years, and these costs are higher than in the other Atlantic Provinces.

Accident Benefits

While an effort was made to collect information in the NL 2018 CCS regarding the benefits paid under Accident Benefits in relation to the settlement costs of TPL- Bodily Injury, insufficient data was available for an analysis.

In 2016, 94.6% of the vehicles included Accident Benefits coverage, with an average premium of $72. We assume for the majority of insured vehicles without Accident Benefits, the primary reason for the exclusion is affordability[7] of the coverage.

We discuss our findings in more detail in the following sections.

[7] In 2016, 82.5% of the Facility Association (the market of last resort) insured vehicles included Accident Benefits coverage. The Facility Association average earned Accident Benefits premium in 2016 was $143.

2. TPL Minimum Limit

The Government of Newfoundland and Labrador is considering increasing the current minimum TPL liability limit of $200,000.

The Nova Scotia minimum TPL limit increased from $200,000 to $500,000 in April 2004. There have been no other recent changes to the minimum limit in other provinces; the minimum limit remains at $200,000 in Ontario, Alberta, New Brunswick, and PEI.

In the following table, we present the number of vehicles at each of the standard TPL limits for all private passenger vehicles in Newfoundland and Labrador for the years 2012 to 2016, as reported by GISA[8].

Table 1: Newfoundland and Labrador TPL Limits

	2012		2013		2014		2015		2016	
Limit Amount	Number of Earned Vehicles	% Dist.	Number of Earned Vehicles	% Dist.	Number of Earned Vehicles	% Dist.	Number of Earned Vehicles	% Dist.	Number of Earned Vehicles	% Dist.
$200,000	10,762	3.61	8,922	2.90	6,826	2.18	5,453	1.70	4,416	1.36
$300,000	669	0.22	599	0.19	555	0.18	488	0.15	431	0.13
$500,000	81,413	27.28	78,109	25.39	73,635	23.47	67,819	21.17	60,247	18.52
$1,000,000	181,287	60.76	194,238	63.15	205,086	65.37	216,747	67.66	227,596	69.97
$2,000,000	23,070	7.73	24,494	7.96	26,368	8.40	28,542	8.91	31,804	9.78
$2,000,001 - $5,000,000	1,178	0.39	1,222	0.40	1,249	0.40	1,273	0.40	777	0.24
Over $5,000,000	4	0.00	2	0.00	0	0.00	0	0.00	0	0.00
All Other Limits	0	0.00	0	0.00	2	0.00	10	0.00	13	0.00
Total	298,383	100.00	307,587	100.00	313,721	100.00	320,332	100.00	325,285	100.00

As presented in the table above, the percentage of private passenger vehicles insured at the minimum $200,000 limit is relatively small and has been declining over time; it was 3.61% in 2012 and it was 1.36% in 2016.

In 2016, 98.64% of all vehicles are insured at limits of $300,000 and higher; and 98.51% are at limits of $500,000 and higher. If the Government chooses to increase the minimum limit from $200,000 up to $300,000 or $500,000, a small percentage of the overall market would be affected.

[8] Statistics provided by GISA in Exhibit AUTO1010 as of December 31, 2016.

The Facility Association is a market of last resort for drivers who cannot obtain insurance from other insurance companies. It is noteworthy that the risks in the Facility Association, which is a subset of the total Industry, would be more affected by an increase in the minimum limit. In 2016, 13.2% of the Facility Association private passenger vehicles in Newfoundland and Labrador (1,407 out of 10,658) are insured at the minimum $200,000 limit. Like the Industry-wide experience, the percentage of risk at the minimum $200,000 limit has been decreasing for Facility Association: at 31.7% in 2012 declining to 13.2% in 2016. Facility Association has a higher share of risks at $200,000 TPL limit than its overall market share of 3.3%[9] in 2016. In 2016, 32% of the private passenger vehicles that were insured at the $200,000 minimum limit in the Province were insured with Facility Association.

The premium increase to change from the minimum $200,000 to higher limits varies by insurer. Based on Facility Association's current premium manual in Newfoundland and Labrador, the percentage increase from a TPL $200,000 limit to a TPL $500,000 limit is an increase of approximately 11%. Other insurers[10] have different percentage increases for the change from a $200,000 limit to a $500,000 limit TPL premium.[11]

Any increase to the TPL minimum limit would also impact Underinsured Motorist coverage. Underinsured Motorist provides coverage to recover from one's own insurer if the at-fault party is an inadequately insured motorist.[12] In 2016, approximately 95% of the private passenger vehicles in Newfoundland and Labrador carried Underinsured Motorist coverage. If the TPL limit is increased from $200,000 to a higher limit, some claim costs previously covered by the Underinsured Motorist coverage would shift to the TPL coverage.

[9] In Exhibit AUTO1010, GISA reports 1,407 of all Facility Association private passenger vehicles (10,658) at a limit of $200,000 in 2016.

[10] Based on our review of six rate filing documents, the increased limit factor from $200,000 to $500,000 ranged from 1.11 to 1.18.

[11] The dollar increase for Facility Association policyholders may be a greater increase than for other policyholders of other companies (even with higher limit percentage factors) due to the relatively higher average premiums for Facility Association.

[12] For example, a claimant with a $1 million TPL limit and Underinsured Motorist coverage can recover from the Underinsured Motorist benefit the difference between the cost of the claim (up to $1 million) and the TPL limit carried by the at fault driver if it is less than the cost of the claim.

3. Direct Compensation-Property Damage

Under the current automobile insurance model in Newfoundland and Labrador, when an accident occurs resulting in physical damage to the vehicle:

- To the extent he/she is not-at-fault, an insured person seeks recovery from the at-fault party's insurer for damages to his/her automobile (and its contents) resulting from a motor vehicle accident. The damages would be paid under the at-fault insured's mandatory Property Damage coverage.
- To the extent the insured person is at-fault, his/her insurer would pay for any damages to the automobile under the Collision coverage (if this optional coverage were purchased), subject to the deductible carried.
- The current coverage model requires the insured to show fault (or negligence) of the other driver in order to collect under the other driver's Property Damage Coverage.

As part of this review, splitting the current Property Damage coverage into two parts: DCPD and Property Damage-tort[13] (PD-Tort) is under consideration.

Under the DCPD coverage, to the extent not at-fault, the insured person would recover from his/her *own* insurer for damages to his/her automobile (and its contents) resulting from a motor vehicle accident; this is a significant change from the current system. To the extent the insured person is at-fault, his/her insurer would pay for any damages to the automobile under the Collision coverage (if this optional coverage were purchased), subject to the deductible carried; this portion is unchanged from the current system.

All other types of third party property damage[14] previously paid under the Property Damage coverage would continue to be paid under the PD-Tort coverage.

The introduction of DCPD is intended to reduce claims processing costs for insurers due to the reduced need for subrogation between carriers. However, statistics are not available to quantify the savings that may have been realized when other provinces introduced this coverage. In addition, it should be noted that insurers will incur one-time IT and administrative costs to introduce the DCPD coverage in Newfoundland and Labrador.

[13] We refer to the proposed (reduced) Property Damage coverage as Property Damage- tort (or PD-Tort), to avoid confusion with the current Property Damage coverage.

[14] Examples of such claims could be a broken fence, a damaged bicycle, etc.

Allocation of Costs to DCPD

To estimate how the current Property Damage coverage claims costs would split into the two components (DCPD and PD-Tort) in Newfoundland and Labrador, we examined how costs were impacted in other provinces in which the Property Damage coverage was split into DCPD and PD-Tort coverages.

DCPD coverage was introduced in Ontario in June 1990 as part of the Ontario Motorist Protection Plan (OMPP), in New Brunswick on January 1, 2005, and Nova Scotia April 1, 2013.[15]

One key difference between the DCPD coverage offered in Ontario as compared to the DCPD coverage offered in New Brunswick and Nova Scotia is that Ontario regulations allow a deductible[16] to be offered on the DCPD coverage, whereas the current New Brunswick and Nova Scotia regulations do not. For purposes of this discussion, we assume that there will be no deductible on the DCPD coverage in Newfoundland and Labrador.

The statistics published by GISA for New Brunswick, Nova Scotia and Ontario ending December 31, 2016 show that over the last five years (or since DCPD was introduced, in the case of Nova Scotia) that the total claim costs for DCPD and PD-Tort combined are approximately split, on average, as follows:

- New Brunswick: 92%[17] DCPD and 8% PD-Tort
- Nova Scotia: 93% DCPD and 7% PD-Tort
- Ontario: 95% DCPD and 5% PD-Tort

Two possible reasons for Ontario's split being slightly different from the other two provinces are: (a) a deductible is an option for DCPD in Ontario and (b) Ontario has a lower Bodily Injury claims frequency rate than the other two provinces[18].

Our understanding is that the DCPD system under consideration in Newfoundland and Labrador is likely to more closely resemble that of New Brunswick and Nova Scotia than that of Ontario. Thus, based on the information presented above, we find an anticipated split of the Property

[15] DCPD coverage was also introduced in Quebec in 1978, but we are unable to access any Quebec statistics regarding the introduction of this coverage.

[16] This was an amendment to the original DCPD coverage, implemented at a later date.

[17] Over the last ten years, the split in New Brunswick is 91%/9%. There is an apparent shift to more costs under DCPD than PD-tort in the last five years.

[18] The Bodily Injury and Property Damage-Tort frequency rates are correlated.

Damage total claims costs into DCPD at 93% and PD-Tort at 7% to be a reasonable initial estimate for Newfoundland and Labrador.

Change in Total Costs for PD-Tort and DCPD Combined[19]

In New Brunswick, there was no apparent change in total DCPD and PD-Tort costs following the introduction of DCPD; the total claims costs were relatively similar immediately prior to and immediately after DCPD was introduced. However, the total number of claims increased and the average claim size decreased, immediately following the introduction of DCPD.

In contrast to this, immediately following the introduction of DCPD in Nova Scotia in April 2013, there was an increase in the total DCPD and PD-Tort claims costs. Prior to the introduction of DCPD, the loss and claims adjustment expense cost per vehicle for claims occurring in the second half of 2012 was $86; this increased to $110 for claims occurring in the second half of 2013. The total DCPD and PD-Tort claims costs per vehicle have continued at this level (and higher) since the introduction of DCPD. Most of the increase is attributed to a higher claims frequency rate (number of claims per vehicle insured) after the introduction of DCPD. We are uncertain of the reason for the increase in the frequency rate associated with the introduction of DCPD in Nova Scotia, but speculate this is partially attributed to the coding of claims by coverage and is somewhat offset by a decrease in collision claims frequency (as further discussed below).

As we are unaware of the reason for the increase in total costs in Nova Scotia, and since a similar increase was not evident when DCPD was introduced in New Brunswick, we do not recommend any adjustment to the DCPD rates for this phenomenon until actual data in Newfoundland and Labrador emerges.

Impact on Collision Coverage

Concurrently with the 2005 introduction of DCPD in New Brunswick, the frequency rate for Collision steeply declined (-21%) while the Collision average cost per claim (severity) increased by an offsetting amount (approximately +25%). As a result, the Collision average claim cost per vehicle was relatively unchanged following the introduction of DCPD despite large changes to the frequency and severity for Collision. We are uncertain as to why the Collision frequency rate declined and severity amount increased coincident with the introduction of DCPD but

[19] Due to the introduction of DCPD in Ontario nearly 30 years ago, we do not consider the change in costs in Ontario before and after the introduction of DCPD.

speculate this is partially attributed to the coding of claims by coverage, and somewhat offset by the increased DCPD frequency, as discussed above.

Similar to the change in Collision in New Brunswick, following the introduction of DCPD in Nova Scotia, we observe the Collision frequency rate to decline steeply (approximately -13.5%) while the Collision average severity amount increased by an almost offsetting amount (approximately +20%). We note that there appears to have been a shift of claims from Collision (decline in frequency rate) to total DCPD and PD-Tort (higher claims frequency rate discussed above) coincident with the introduction of DCPD in Nova Scotia. We are uncertain of the cause of the change, but again speculate this is partially attributed to the coding of claims by coverage.

While this change to Collision is evident in both provinces where DCPD was introduced at different times, there does not appear to be an impact on the overall average claim cost per vehicle for the Collision coverage (due to the increase in severity largely offsetting the decrease in frequency). Accordingly, we suggest no adjustments to the Collision rate are warranted with the initial introduction of DCPD; however, the actual emerged data should be monitored for any possible impact and adjustments should be considered in the future if supported by data.

We also suggest, as has been done in Nova Scotia and New Brunswick, that insurers be encouraged to expand the rating factors for DCPD coverage to include the vehicle make and model year (i.e., vehicle rate group[20]) so as to more fairly and accurately measure the risk of each insured vehicle. This is also consistent with the rating of other physical damage coverages. Introducing this variable will reduce the DCPD premium for some insureds, and increase the DCPD premium for other insureds.

[20] This is generally referred to as the CLEAR vehicle rate group factors that are widely used by insurers for rating the Collision coverage.

4. Uninsured Automobile

The Uninsured Automobile (UA) coverage recovers the cost of the benefits a person would be legally entitled to recover from the owner or driver of another vehicle for Bodily Injury, Death, and Property Damage in the event that the other vehicle is uninsured or unidentified.[21]

The coverage is mandatory in Newfoundland and Labrador, as it is in Nova Scotia, New Brunswick, Prince Edward Island, Ontario, and Alberta[22].

As reported by GISA,[23] in Newfoundland and Labrador over the last five years ending 2016, on average, there are 5 UA claims for every 10,000 insured vehicles each year. The average premium for UA coverage over the same five years is $19 each year. However, over this same period, the average cost of claims and claims handling expenses per vehicle for this coverage has been increasing, with accident year 2012 at $14, increasing to $19 in 2016.

The claims frequency rate is higher in Newfoundland and Labrador than in the other Atlantic Provinces. Specifically, GISA reports an average of 3 UA claims for every 10,000 insured vehicles for the last five years ending 2016 for both of Nova Scotia and New Brunswick, and 4 UA claims for every 10,000 vehicles in Prince Edward Island during this same time period. For the five year period ending 2016, average cost of claims and claims handling expenses per vehicle was $5 in New Brunswick, $9 in Nova Scotia, and $7 in Prince Edward Island.

We assume that, on average, higher UA claims frequency rates are associated with a higher percentage of uninsured vehicles. However, data to compare differences in the number of uninsured vehicles in each Province is not available.

[21] The exception is that In the event of Property Damage caused by an unidentified automobile, UA will not provide coverage.

[22] UA is packaged with Accident Benefits in Alberta; it is not sold as a separate coverage in that Province.

[23] GISA AUTO 1005 as of December 31, 2016

5. Accident Benefits

Relationship of Section B and Section A Settlements

As part of the NL 2018 CCS, the survey asked for information pertaining to amounts collected under Accident Benefits from the third party's own insurer that reduced the amounts paid by the first party insurer under the Bodily Injury coverage. However, the majority of claimant data files did not include this information and it was (therefore) coded as "unknown" in the survey.

Specifically, as we stated in our Closed Claim Summary Report dated April 19, 2018, "*Insurers were asked to report Medical Rehabilitation Costs and Disability Income Costs pertaining to Auto No-Fault (Section B). For the majority of claimants (87%), these items were reported as "unknown." For the 235 claimants that had reported Medical and Rehabilitation Costs, the average Medical and Rehabilitation Costs were $3,058. For the 234 claimants that had reported Disability Income Costs, the average paid Disability Income Costs were $462."*

Further, IBC, who validated the data collected for the NL 2018 CCS, is unable to verify the reported data for the Section B questions in the survey. For these reasons, we are unable to comment on the relationship of Section B benefits on the settlement of Section A benefits.

Mandatory Section B (Accident Benefits)

The Government is considering making Accident Benefits a mandatory coverage in Newfoundland and Labrador. As reported by GISA, 94.6% of the vehicles had Accident Benefits coverage in 2016, with an average premium of $72. We assume for the majority of remaining insured vehicles without Accident Benefits, the primary reason for the exclusion is affordability[24] of the coverage.

Given that the vast majority of insured vehicles currently include Accident Benefits, a change to a mandatory requirement of Accident Benefits is anticipated to have little impact on the total (aggregated) Industry premiums, losses or profitability.

[24] In 2016, 82.5% of insured vehicles by the Facility Association (the market of last resort) included Accident Benefits.

6. Distribution and Use

- This report was prepared for the sole use of the Newfoundland and Labrador Board of Commissioners of Public Utilities (Board). All decisions in connection with the implementation or use of advice or recommendations contained in this report are the sole responsibility of the Board.

- Oliver Wyman's consent to any distribution of this report (whether herein or in the written agreement pursuant to which this report has been issued) to parties other than the Board does not constitute advice by Oliver Wyman to any such third parties and shall be solely for informational purposes and not for purposes of reliance by any such third parties. Oliver Wyman assumes no liability related to third party use of this report or any actions taken or decisions made as a consequence of the results, advice or recommendations set forth herein. This report should not replace the due diligence on behalf of any such third party.

7. Consideration of Limitations

- For our review, we relied on data and information available from GISA and IBC without independent audit. Though we have reviewed the data for reasonableness and consistency, we have not audited or otherwise verified this data. It should also be noted that our review of data may not always reveal imperfections. We have assumed that the data provided is both accurate and complete. The results of our analysis are dependent on this assumption. If this data or information is inaccurate or incomplete, our findings and conclusions may need to be revised.

- Our conclusions are based on an analysis of the data and on the estimation of the outcome of many contingent events. Future costs were developed from the historical claim experience and covered exposure, with adjustments for anticipated changes. Our estimates make no provision for extraordinary future emergence of new classes of losses or types of losses not sufficiently represented in historical databases or which are not yet quantifiable.

- While this analysis complies with applicable Actuarial Standards of Practice and Statements of Principles, users of this analysis should recognize that our projections involve estimates of future events, and are subject to economic and statistical variations from expected values. We have not anticipated any extraordinary changes to the legal, social, or economic environment that might affect the frequency or severity of claims. For these reasons, no assurance can be given that the emergence of actual losses will correspond to the projections in this analysis.

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