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1 March 2017

Ms. Cheryl Blundon
Board Secretary
Board of Commissioners of Public Utilities
P.O. Box 21040
St. John's, Newfoundland and Labrador
A1A 5B2

Subject:
**Facility Association**
**Newfoundland and Labrador -Taxis, Jitney's & Liveries**
**Category 2 Rate Application**

Dear Ms Blundon:

## Introduction

In accordance with your request, Oliver, Wyman Limited (Oliver Wyman) reviewed the Taxi, Jitney and Liveries (hereafter referred to as taxi) rate application submitted by Facility Association (hereafter referred to as FA).

## Summary of Findings

FA Proposal

As presented in its application, FA proposes to increase its average rates for Third Party Liability (TPL) by 30.7%, Accident Benefits (AB) by 22.8%, and Uninsured Auto (UA) by 53.7%. FA proposes to decrease its average rates for physical damage coverages: Collision by 9.3%, Comprehensive by 11.8%, and Specified Perils by 7.0%. (FA's physical damage coverage rates are based on a percentage of its private passenger rates and the individual multipliers would be adjusted accordingly.) FA estimates its proposed overall rate level change for all coverages combined (including physical damage) is an increase of 29.7%.

FA Indication

FA presents its estimate of its rate level change need on three bases, each with a different return on equity (ROE)/cost of capital (COC)[1] target and a different pre-tax return on investment rate (ROI) assumption:

1. a ROE target of 12%; an assumed ROI of 0.47%; and FA's selected loss trend rates, full credibility standards, and complement of credibility
2. no cost of capital (target COC of 0%); an assumed ROI of 0.47%; and FA's selected loss trend rates, full credibility standards, and complement of credibility
3. no cost of capital (target COC of 0%); an assumed ROI of 2.8%; and FA's selected loss trend rates, full credibility standards, and complement of credibility

The base with the target ROE at 12% and assumed ROI at 0.47% (i.e., #1, above) represents FA's best estimate of its rate level change need. However, the two bases with the target COC set at 0% are also provided by FA as it understands the Board does not accept a cost of capital provision in the FA rates. The ROI at 2.8% is presented because FA understands the Board's Guideline ROI range is 2.8% to 4.0%. The following table presents these indications provided by FA, along with the proposed changes.

**Table 1**

| Base | TPL | AB | UA | Collision | Comp | SP | All |
|---|---|---|---|---|---|---|---|
| 12% ROE & 0.47% ROI | +58.3% | +45.7% | +82.8% | +3.5% | +0.9% | +6.4% | +56.6% |
| 0% COC & 0.47% ROI | +40.9% | +29.6% | +62.1% | -7.9% | -10.2% | -5.3% | +39.4% |
| 0% COC & 2.80% ROI | +30.7% | +22.8% | +53.7% | -9.3% | -11.8% | -7.0% | +29.7% |
| Proposed | +30.7% | +22.8% | +53.7% | -9.3% | -11.8% | -7.0% | +29.7% |

Hence, FA is proposing a rate level change for each of the coverages that is the same as its estimate of its overall rate level change need based on the indicated change with a 0% target

[1] The rate indications based on a COC target exclude investment income expected to be earned on the capital; whereas the rate indications based on a ROE target include the investment income expected to be earned on the capital.

COC; an assumed 2.8% ROI; and FA's selected loss trend rates as of December 2015, full credibility standards,[2] and complement of credibility.

FA estimates the proposed average premium increase (for all coverages combined) is approximately $1,762 per vehicle. The following table presents the current rate level average premiums and the proposed average premiums for TPL, AB, UA, and for all coverages combined.

**Table 2**

| | **TPL** | **AB** | **UA** | **Total[3] All Coverages** |
|---|---|---|---|---|
| Current Average Premium | $5,210 | $455 | $176 | $5,931 |
| Proposed Average Premium | $6,809 | $559 | $271 | $7,693 |
| Proposed Average **Change** ($) | +$1,599 | +$104 | +$95 | +$1,762 |

TPL, AB and UA premiums comprise approximately 97% of FA's total written premiums at the current rate level, with the balance (3%) for the physical damage premiums.

For the year 2012, FA estimated its average written premium for TPL, AB and UM was $1,889, $40, and $7, respectively - a total for these coverages of $1,936. Since 2012, FA has received approval for four rate increases, with the current total average written premium for TPL, AB and UM combined estimated at $5,841 - an increase of 201% or $3,905. The currently proposed increase of $1,798 for these three coverages implies a total increase of 295% (or $5,703) since 2012.

Given the relatively large rate changes approved by the Board since 2012 and the relatively large rate changes that continue to be indicated, consideration should be given to determining what is

[2] The full credibility standards selected by FA are different than those previously approved by the Board for FA.
[3] Total All Coverages represents a weighted average based on the premium distribution and includes the physical damage coverages that are not shown in the table.

causing FA's poor claim experience and commensurately large rate level indications. We discuss FA's poor claims experience below.

Findings - Issues

FA's proposed overall rate level change of +29.7% is based on "alternate" assumptions[4] that, with three exceptions, are in keeping with the Board's Guidelines and recent Decisions on FA Taxi rate applications. The three exceptions are as follows:

1. the selected loss trend rates
2. the full claim count credibility standard for certain coverages
3. the complement of credibility

We discuss these assumptions below.

However, as we discuss later, even if these three assumptions are replaced by those that are in line with the Board's Guidelines and recent Decisions, the rate indication continues to remain high – and this is concerning. Over the five years ending 2015 FA has reported claim costs of $20.2 million, which far exceed the $10.4 million in written premium that FA has collected over this same five year period.

**Background**

FA originally submitted a rate application for an overall proposed rate level change of +29.7% with a target effective date of October 1, 2017 for new business and renewals. Oliver Wyman received a copy of the rate application on December 23, 2016 from FA. On January 9, 2017 we provided our questions on the rate application to FA, and received FA's responses on January 19. We now have sufficient information to prepare this report.

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[4] These alternate assumptions differ from those that it would otherwise make. They were selected by FA as it believes the Board will find them reasonable. They include a 0% cost of capital (instead of 12% ROE) and a pre-tax return on investment of 2.8% (instead of 0.47%).

FA's last approved rate change was for an average increase of 25.7%, effective March 1, 2017; that filing was submitted in March 2016. Prior to this rate change, FA increased its average rate level by 28.9% on June 1, 2016, 19.3% on September 1, 2015, and 50.1% on August 1, 2013.

FA proposes an effective date of October 1, 2017. This would be FA's second increase in 2017.

**Findings - Introduction**

FA calculates three sets of rate level indications for all coverages based on different profit and investment rate targets/assumptions, and proposes changes in its rate level for each coverage based on its findings.

For simplicity, for the remainder of this document we only discuss the FA rate indications assuming a target 0% COC (consistent with the Board's Decisions in the four prior filings), and an assumed ROI of 2.8% (consistent with the Board's Guideline minimum ROI). These are the alternate assumptions that we referred to earlier in this report.

FA's indicated and proposed rate level changes by coverage are summarized in the following table.

**Table 3**

| Coverage | FA's Proposed[5] Rate Changes (ROI at 2.8% COC at 0.0% and FA's Loss Trend Rates) | FA's Indicated Rate Changes (ROI at 2.8% COC at 0.0% and FA's Loss Trend Rates) |
|---|---|---|
| TPL | +30.7% | +32.9% |
| Accident Benefits | +22.8% | +25.1% |
| Uninsured Auto | +53.7% | +56.3% |
| Collision | -9.3% | -7.7% |
| Comprehensive | -11.8% | -10.2% |
| Specified Perils | -7.0% | -5.2% |
| All Perils | -12.7% | -11.0% |
| Total | +29.7% | +31.9% |

**Findings – Rate Level Changes**

As support for FA's proposed changes, FA calculates and presents a rate level need by coverage based on its Newfoundland and Labrador (NL) loss experience arising from the latest five accident years (2011 to 2015) ending December 31, 2015 as compiled by GISA. We refer to this five-year period as the experience period. We reviewed the rate level indications (as presented in Table 3 above) developed by FA, and in so doing have examined all aspects of the ratemaking procedure. The following are the key assumptions in FA's rate application.

- *Loss Trends* – FA selects loss trend rates based on its review of Industry commercial vehicles data as of December 31, 2015 to project its historical loss experience to the average accident date of its proposed rate program. We discuss FA's selected loss trend rates below.

[5] FA's proposed rate changes are based on its original rate filing documentation that omitted an adjustment for the change in the HST rate effective July 2016. FA's indicated changes as presented in Table 3 are based on the amended (or updated) indications provided by FA in response to our questions dated January 9, 2017.

- *Premium Trends and On-Level Factors* – FA adjusts its premiums to take into consideration its rate level changes in the recent past. We find these on-level adjustments to be reasonable.

- *Selection of Ultimate Losses (loss development)* - FA relies upon its non-PPV (commercial, motorcycles, snow vehicles, taxis, etc.) NL experience in selecting development factors that it applies to its reported incurred losses for taxis. (FA's reported incurred losses do not include allocated loss adjustment expenses.) We find these estimates to be reasonable.

- *Selection of Ultimate Claim Counts (claim count development)* – FA relies upon its non-PPV (commercial, motorcycles, snow vehicles, taxis, etc.) NL experience in selecting development factors that it applies to its reported claim counts for taxis. We find these estimates to be reasonable.

- *Experience Period Weights* - For each coverage, FA combines its experience over the five accident years by assigning a 20% weight to each year. We find the weights to be reasonable and consistent with its prior filing.

- *Loss Adjustment Expense (LAE)* – FA's LAE provision (for both internal and external claim settlement related expenses) is based on the contractual arrangement between FA and its servicing carriers, which, in turn, is based upon the FA's loss ratio results. We find these estimates to be in line with the contractual arrangements. However, the actual LAE costs are not provided by FA to support these provisions.

- *Health Levy (HL)* – FA has not included a provision for the HL. This is consistent with FA's treatment of the HL in prior filings.

- *Full Credibility Claim Count Standards* – FA selects full credibility claim count standards that for certain coverages are different than those approved by the Board for FA in its prior filing. We discuss this issue more fully below.

- *Complement of Credibility* - To the extent that FA determines its own loss experience is not statistically credible, FA assigns the balance of credibility to the net loss/premium trend rate since the effective date of its last rate change, with an adjustment to provide for its estimate of the resulting inadequacy in its current rate level (due to FA implementing a smaller rate increase than it had estimated was needed at the time of the prior application). We discuss this issue more fully below.

- *Expense Provision* - FA assumes a total expense provision of 24.87% allocated as follows: (a) variable: 6% standard commissions, 5% premium tax, 1% servicing carrier fee, 0.19% miscellaneous regulatory fees, and 9% servicing carrier operating costs - for a total variable expense provision of 21.19% of premium; and (b) fixed: 1.18% for driving record abstracts and 2.5% for central office expenses - for a total fixed expense provision of 3.21% of premium. The 6% commission rate is based on an agreement between the FA Board and its servicing carriers. The 5% premium tax rate is set by the provincial government. The servicing carrier fee of 1% and servicing carrier operating costs of 9% are based on an agreement between the FA Board and its servicing carriers, rather than the actual costs and expenses of the servicing carriers for processing taxi policies. The fixed expense costs are based on estimates by FA, taking into consideration its most recent actual costs and proposed rate level change.

- *Contingent Commissions* – In calculating its rate level change need, FA does not include a contingent commission provision. We find this assumption to be in keeping with the Board's Guidelines.

- *Finance Fee Revenues* - FA does not offer a monthly payment plan and there are no finance fees paid by the taxi policyholders.

- *Profit Provision (Cost of Capital)* – Although FA believes it should include a target 12% ROE provision, since FA acknowledges the Board's approval of FA's prior rate change based on a target COC of 0% it presents its rate indications based on a 0% COC.

- *Investment Income on Cash Flow* (ROI) – Although FA estimates its ROI to be 0.47%, since FA acknowledges the Board's minimum ROI is 2.8% it presents its rate indications based on an ROI of 2.8%.

- *HST Adjustment* – In its original filing documentation, FA omitted an adjustment to its historical loss experience for the change in the HST rate from 13% to 15% effective July 1, 2016 - an increase of +1.8%. In response to our question on this omission, FA provided amended indications by increasing all its historical loss experience (for all coverages) by +1.8%; and as a result increased its overall rate level estimate of +29.7% to +31.9%. However it is our understanding that the HST rate is only applicable to the Property Damage (PD) portion of TPL and to the physical damage coverages. While we do not know the exact split of BI and PD for taxis, FA's estimate of non-PPV ultimate losses for TPL are split, on average over the last ten years, at 86%/14% for BI/PD. On this basis, we estimate the change to the HST rate would increase the original overall rate level indication as estimated by FA from +29.7% to +30.1%.

Based on our review of the application and the responses to the questions we have raised, we present below a discussion of the following assumptions used by FA for the Board's consideration: (1) the selected loss trend rates, (2) the full claim count credibility standard, and (3) the complement of credibility base.

*Loss Trend Rates*

The loss cost trend rates are used to adjust the actual claim experience that occurred in the experience period to the cost level of the period in which the proposed rate program is to be in effect.

The Industry experience for taxis, which are categorized as public vehicles for statistical reporting purposes, is too limited for use in selecting loss trend rates. FA, therefore, bases its selected loss trend rates on the NL Industry commercial vehicle (CV) loss experience. As the Board has no guideline on the data to be used to select trend rates for taxis, and FA's use of Industry CV experience for determining loss trends is consistent with its prior approach, we find the use of Industry CV experience to be reasonable.

Based on Industry CV experience in NL as of December 31, 2015, FA selects its CV loss cost trend rates for each coverage by separately selecting frequency and severity trend rates and then combining these selected trend rates to arrive at its selected loss cost trend rates[6].

The following table summarizes the CV loss cost trend rates[7] selected by and FA and Oliver Wyman (and approved by the Board) as of December 31, 2015.

[6] FA uses the same trend rate for both past and future trend periods.
[7] Oliver Wyman uses the same trend rate for both past and future trend periods.

**Table 4**

| Loss Cost Trend Rates | **FA December 2015** | **Oliver Wyman December 2015** |
|---|---|---|
| Bodily Injury | +3.5% | +2.0% |
| Property Damage | +2.1% | +2.0% |
| Accident Benefits | +0.0% | +7.0% |
| Uninsured Auto | +8.1% | +7.0% |
| Collision | +0.0% | +0.0% |
| Comprehensive | +0.0% | +0.0% |

As presented in the table above, the CV loss cost trend rates selected by FA are higher than those selected by Oliver Wyman for Bodily Injury and Uninsured Auto, lower for Accident Benefits, and essentially the same for the other coverages.

We presented our rationale for the CV trends rates that we selected in our Commercial Vehicle Loss Trend Report filed September 13, 2016 to the Board. As we have stated in our trend reports to the Board, we find that the considerable volatility in the Industry CV experience makes the trend patterns difficult to identify.

The differences between the trend rates selected by Oliver Wyman and those selected by FA are generally due to different judgments regarding: (1) trend measurement period, (2) selected loss development factors, (3) inclusion/exclusion of loss adjustment expenses, and (4) FA's application of level change adjustments.

*Accident Benefits*

In the case of Accident Benefits, where there is the largest difference, FA has changed its trend model from its prior review. In its prior review FA selected a loss cost trend rate of +6.4% with no level change parameter. We note that the +6.4% is not too different from our selected trend of +7.0%. However, in the current filing, based on its analysis, FA finds a change in loss cost level of +85% to have occurred at 2011-2; and when this level change is considered the indicated loss cost trend rate is 0% (no trend). As we state in our loss trend report, the Accident Benefits data is very volatile making it difficult to discern a trend pattern. Hence, while different than our selection, we do not find FA's selection unreasonable.

We note that substituting the Board's Guideline Accident Benefits loss trend rate instead of FA's selection, and no other changes in assumptions, increases FA's rate indication for Accident Benefits from +22.8% (as originally calculated by FA) to +44.4%.

*Bodily Injury*

The difference in trend rates is smaller for Bodily Injury.

FA separately selects frequency and severity trend rates of +0.0% and +3.5%, respectively, based on the regression analysis it performed on its estimate of Industry CV ultimate losses and claim counts by accident half year over the 20-year period ending December 31, 2015. FA, therefore, selects a loss cost trend of +3.5%.

We note that in its prior review, based on Industry experience through December 31, 2014, FA selected a frequency trend rate of -2.3%, a severity trend of +4.8%, and, therefore, a loss cost trend of +2.4%.

As presented in our trend report to the Board, we selected a frequency trend of -2.0%, and severity trend of +4.0%, and a loss cost trend of +2.0%. Hence the difference is primarily due to the selected frequency trend rate.

Over the past year (since FA's prior review), BI claim frequency continued to decline. Nevertheless, FA increased its selected frequency trend rate from -2.3% to +0.0%. FA explains that it now finds it reasonable to assume that Bodily Injury frequency trend should track with that of Property Damage, Collision and Accident Benefits, for which FA (as does Oliver Wyman) selects a frequency trend rate of 0.0%. As we stated in our response filed October 12, 2016 to FA's comments about our recommended CV trend rates, we do not accept FA's rationale for selecting a frequency trend of 0.0%.

FA's selected severity trend rate of +3.5% is in line with our selected severity trend of +4.0% rate.

We note that substituting the Board's Guideline Bodily Injury loss trend rate instead of FA's selection, and no other changes in assumptions, decreases FA's rate indication for TPL from +30.7% (as originally calculated by FA) to +26.2%.

*Summary*

The rate level impact of substituting each of the Board Guideline loss trend rates as of December 31, 2015 for those selected by FA, reduces FA's estimated rate level change by approximately 2.6[8] percentage points.

Given the uncertainty and volatility of the underlying loss experience, and that FA measures trends based on data that excludes loss adjustment expenses, we do not find FA's selected loss trend rates to be unreasonable except for Bodily Injury where we find its selected loss cost trend rate of 3.5% to be high.

*Credibility Standards*

The following Table 5 presents the full credibility claim count standards and the calculated credibility levels based on FA's taxi experience using three alternate standards: (1) FA's proposed standards, (2) the Board's Guideline standards and (3) the standards approved by the Board for FA's 2013 taxi filing (which the Board has continued to accept in FA's subsequent taxi filings).

As can be seen in the table:

- FA's proposed credibility standards for Accident Benefits and Collision are the same as both FA's originally approved standards and the Board Guideline standards

- FA's proposed credibility standard for Uninsured Auto is the same as FA's originally approved standard, but is lower that the Board Guideline standard

- FA's proposed credibility standards for Comprehensive and Specified Perils are considerably lower than FA's originally approved standards, but are the same as the Board Guideline standards

- FA's proposed credibility standard for TPL is lower than both FA's originally approved standard and the Board Guideline standard.[9]

[8] This includes changes to the selected trend rates for Bodily Injury, Uninsured Auto and Accident Benefits.

[9] Taxi claim counts are only available for TPL on an indivisible basis, not for BI and PD separately. FA's TPL proposed standard is based on 2,164 claim counts for BI and 1,082 claim counts for PD, which, when added together equal 3,246. The Board's Guideline TPL standard is based on 3,246 claim counts for BI and 1,082 claim counts for PD, which, when added together equal 4,328. FA's originally approved standard for TPL was initially presented by

- FA is requesting the Board accept changes to its TPL and Comprehensive/Specified Perils standards.

As can also be seen in the table, the credibility weights assigned to FA's experience under its proposed standards are either higher or the same as the credibility weight that would be assigned under the Board's Guideline standards or its originally filed standards (which the Board had approved for FA to use).[10]

**Table 5**

| Full Credibility Claim Count Standards | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 5 Year Claim Count | **FA Proposed Standard** | | **Board Guideline** | | **FA Original Standard ( Board Approved)** | | |
| | | Standard | Credibility | Standard | Credibility | Standard | Credibility | |
| TPL | 806 | 3,246 | 49.8% | 4,328 | 43.2% | 5,410 | 38.6% | |
| Accident Benefits | 226 | 2,164 | 32.3% | 2,164 | 32.3% | 2,164 | 32.3% | |
| Uninsured Auto | 26 | 2,164 | 11.0% | 3,246 | 8.9% | 2,164 | 11.0% | |
| Collision | 42 | 1,082 | 19.7% | 1,082 | 19.7% | 1,082 | 19.7% | |
| Comprehensive | 34 | 1,082 | 17.7% | 1,082 | 17.7% | 3,246 | 10.2% | |
| Specified Perils | 9 | 1,082 | 9.1% | 1,082 | 9.1% | 3,246 | 5.3% | |

In its prior 2014 taxi filing Decision the Board had not accepted FA's proposed changes to the credibility standards that FA first used in NL. The basis for the Board's Decision for the 2014 taxi

FA on an indivisible basis without the underlying BI and PD components; but in subsequent documentation, FA stated that its original TPL standard was based on 2,164 claim counts for BI and 3,246 claim counts for PD.

[10] For those coverages where FA estimates a rate increase is needed, FA's lower proposed standards will result in a higher rate level indication (all else being equal); for those coverages where FA estimates a rate decrease is needed based on its current experience, FA's lower proposed standards will result in a lower rate level indication (all else being equal).

filing was that changes to credibility standards must be based on supporting justification for any associated rate increases, which, based on our findings, FA had failed to do to the Board's satisfaction. The Board continued to take this position in the subsequent filings in 2015 and March 2016.

We summarize the positions and rationale provided by FA in its recent past taxi filings.

- FA's originally filed credibility standards were submitted in FA's 2013 taxi filing. In that filing FA's actuary at that time, Eckler, presented Atlantic data as of 2003 and calculations to support FA's proposed credibility standards, which the Board accepted.

- Beginning with its 2014 taxi filing, when Eckler was no longer FA's actuary, FA has attempted to move away from the "Eckler standards" by proposing standards for TPL, Comprehensive, and Specified Perils that were lower than the "Eckler standards." However, it was our stated position that FA hadn't provided strong rationale for changing its standards; and the Board accepted our position.

- In FA's 2015 taxi filing FA again proposed credibility standards that were lower than the "Eckler standards." FA stated (in the actuarial memorandum) that while its proposed lower standards were judgmentally selected (i.e. with no supporting analysis other than graphs depicting the volatility), they result in lower volatility ("limited fluctuation") of results and are used by FA in other jurisdictions for both private passenger and commercial vehicles. However, their use also resulted in higher rate level indications than under the "Eckler standards." It was our stated position that the explanations and graphs provided by FA was not strong enough rationale to change to credibility standards that resulted in a higher rate level indication (by approximately 7 percentage points). We further supported our position by duplicating the TPL analysis performed by Eckler using more recent industry Atlantic data (Accident Years 2009, 2010 and 2011 as of December 31, 2013) and finding the results to be in line with those of Eckler. The Board accepted our position.

- In FA's March 2016 taxi filing, FA repeated its position. But, as a means to have its filed rates approved, FA proposed to use the Board's Guideline standards. It was again our position that FA had not provided new information to support a change in credibility standards that resulted in a higher rate level indication. However, we suggested that whether or not to permit FA to use the Board's Guideline standards, that are used by other insurers in the Province, was a policy decision for the Board to make. Ultimately, the Board decided not to accept FA's proposed change to the Board's Guideline standards.

In this current filing (December 2016), FA has proposed a change in credibility standards for three coverages[11] and essentially repeats the rationale for its proposed changes it had provided in previous filings. FA also addresses the shortcomings of the Eckler analysis and standards and presents reasons why an update of the Eckler study using Atlantic data (such as the one we performed for the 2015 filing) is not appropriate. FA also states in this filing that it does not object to the use of the Board's Guideline standards.

We continue to find that FA's rationale does not support the standards it has proposed. But we agree that using data from the Atlantic Provinces, which have different minor injury definitions and caps, could distort an analysis of credibility standards for the Bodily Injury coverage, although the findings of the updated study we had performed were in line with those of the prior Eckler study.[12]

We note, though, a very important difference in this filing as compared to prior FA filings. In this current filing FA's adoption of the Board's Guideline standards would not result in a materially[13] higher rate level indication. It is our understanding that a lower rate indication alone does not meet the Board's requirement for rationale/support for a change in assumption. However, we are of the view that because adopting the Board Guideline Standards would not result in a materially higher rate indication that the bar that FA must meet should now be lower.

We continue to suggest that whether or not to allow FA to use the Board's Guideline Standards is a policy decision for the Board to make. However, given (a) that FA does not object to the use of the Board's Guideline standards, (b) that the adoption of the Board's Guideline standards would not result in a materially higher rate level indication (as had been the case in prior filings), (c) the limitations of an update to the Eckler study, and (d) that every other insurer uses the Board Guideline standards, we recommend the Board allow FA to use the Board's Guideline standards.

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[11] We note that FA has not proposed to change its credibility standard for AB, Collision, and Uninsured Auto. In the case of AB and Collision, FA's approved and proposed standards are the same as the Board Guideline Standards. FA's approved and proposed standard for Uninsured Auto (2,164 claims) is lower than the Board Guideline Standard (3,246 claims). For reasons of consistency and materiality, and that (a) the use of the Board's Guideline Standard instead of FA standard reduces the rate level indication for Uninsured Auto and (b) FA does not object to the use of the Board Guideline Standards, we would find use of the Board Guideline Standard for Uninsured Auto to be reasonable.

[12] There isn't enough commercial vehicle data in Newfoundland and Labrador to conduct a credibility study based on the Province's data only.

[13] The difference in the rate indication is less than 1 percentage point, which we find to be immaterial especially given that the Eckler credibility standards were based on commercial vehicle data, and not taxi data.

*Complement of Credibility*

In this rate application, FA applies net trend as the complement of credibility, but in so doing makes an adjustment to reflect the rate inadequacy it believes resulted from the Board's prior approval of a much lower rate level change than FA found was required at the time of its last filing.

In its prior rate application, FA proposed a rate increase of +27.4%; which was less than FA found was required at the time.

As stated in the Board's Decision A.I.14 (2016) regarding the FA prior application, the Board Decision was based on FA's 2013 full credibility standards, the Board's loss trend rates and a complement of credibility without any adjustment for rate inadequacy, a COC of 0.0%, and an ROI of 2.8%. The Board approved a rate change of +25.7%.

The 2 percentage point difference between the proposed rate change and approved rate change is due to different full credibility standards applied. The proposed change of +27.4% is based on the Board's Guideline standards and the approved rate change of +25.7% is based on Eckler's standards.

It is our understanding that FA considers it rate level need at the time of its last filing should have been based on its selected full credibility standards, its selected loss trend rates and the complement of credibility with an adjustment for any rate inadequacy. As a result, FA makes what it finds to be a reasonable adjustment to the net trend for its current rate inadequacy.

The net trend approach used by FA to determine its complement of credibility is a reasonable and appropriate methodology used by other actuaries. However, it is highly dependent on the previously assumed level of rate adequacy underlying the current rates. While it is not unusual for there to be a difference in view regarding the current rate adequacy level, the difference between the Board's view and FA's view is unusually large. This difference is largely due to the long lag between FA's 2013 rate filing and its previous rates dated 1993, combined with the relatively low level of credibility of FA's experience.

Although making no adjustment for rate inadequacy is consistent with the Board's Decision on FA's prior rate application, we again note that FA's taxi experience continues to be poor:

- Over the ten-year period 2006-2015 FA's reported claim costs (indemnity costs, undeveloped) are in excess of $30 million as compared to its collected premium of approximately $17 million.

- For the 2015 accident year (which was not reflected in FA's last filing), FA estimates its ultimate claim costs (indemnity costs, developed) to be $4.5 million as compared to its collected premium of $2.4 million.

This means two things. First, the fact that FA's taxi experience continues to deteriorate suggests that net trend alone is not a true representation of FA's rate level needs. Second, due to FA's relatively low number of risks, the net trend approach coupled with the Board's estimate of FA's current rate level adequacy and low credibility of FA's taxi experience (by any measure), without any adjustment for rate inadequacy, is slow to recognize FA's poor taxi experience. That is, assuming a continuation of FA's poor experience, it will take several more years for FA's taxi rates to achieve adequacy. (If the Board accepts changing FA's credibility standards for TPL and Comprehensive/Specified Perils, more weight would be assigned to FA's poor taxi experience.) While this situation was largely brought on by FA not submitting a taxi filing for many years until 2013, we believe the Board should consider FA's continued poor experience in making its Decision about the complement of credibility.

**Rate Level Change Summary**

We reviewed the rate level indications as developed by FA and in so doing have examined all aspects of its ratemaking methodology.

We calculate that in making changes to:

1. (a) a full credibility standard consistent with that approved by the Board for each of the past four taxi rate applications

1. (b) a full credibility standard consistent with the Board Guideline standards for all coverages other than Uninsured Auto

2. FA's credibility complement basis to exclude the adjustment for rate inadequacy

3. FA's application of the impact of change in the HST rate to Bodily Injury, Accident Benefits and UA coverages at 1.8% to 0.0%

4. The Board's Guideline loss trend rate for BI of +2.0% instead of FA's selected loss trend rate for BI of +3.5%

would lead to overall rate level indications that are less than the rate level need that the FA has proposed.

The following tables present FA's calculations of its indicated and proposed changes and those that we derive by applying:

Scenario A: 1(a), 2, and 3
Scenario B: 1(b), 2, and 3
Scenario C: 1(a), and 3
Scenario D: 1(b), and 3

Scenario E: 1(a), 2, 3, and 4
Scenario F: 1(b), 2, 3, and 4
Scenario G: 1(a), 3, and 4
Scenario H: 1(b), 3, and 4

**Table 6: ROI at 2.8% and COC at 0.0% (Without Adjustment for BI Loss Trend)**

| Coverage | FA's Indicated[14] Rate Changes | FA's Proposed Rate Changes | Scenario A | Scenario B | Scenario C | Scenario D |
|---|---|---|---|---|---|---|
| TPL | +32.9% | +30.7% | +17.5% | +18.8% | +29.7% | +30.2% |
| AB | +25.1% | +22.8% | +13.2% | +13.2% | +22.8% | +22.8% |
| UA | +56.3% | +53.7% | +33.5% | +33.5% | +53.7% | +53.7% |
| Coll. | -7.7% | -9.3% | -2.6% | -2.6% | -7.7% | -7.7% |
| Comp. | -10.2% | -11.8% | -7.4% | -9.3% | -8.6% | -10.2% |
| SP | -5.2% | -7.0% | -7.5% | -8.3% | -4.6% | -5.3% |
| AP | -11.0% | -12.7% | -6.5% | -6.5% | -11.0% | -11.0% |
| Total | +31.9% | +29.7% | +17.0% | +18.1% | +29.0% | +29.3% |

[14] These indicated changes include the HST adjustment applied by FA after its rate application was submitted.

FA's proposed overall rate level change of +29.7% is higher than the indications we calculate based on these 4 scenarios; materially higher than scenarios A and B, and modestly higher than scenarios C and D.

**Table 7: ROI at 2.8% and COC at 0.0% (With Adjustment for BI Loss Trend)**

| Coverage | FA's Indicated Rate Changes | FA's Proposed Rate Changes | Scenario E | Scenario F | Scenario G | Scenario H |
|---|---|---|---|---|---|---|
| TPL | +32.9% | +30.7% | +13.8% | +14.9% | +26.0% | +26.1% |
| AB | +25.1% | +22.8% | +13.2% | +13.2% | +22.8% | +22.8% |
| UA | +56.3% | +53.7% | +33.5% | +33.5% | +53.7% | +49.6% |
| Coll. | -7.7% | -9.3% | -2.6% | -2.6% | -7.7% | -7.7% |
| Comp. | -10.2% | -11.8% | -7.4% | -9.3% | -8.6% | -10.2% |
| SP | -5.2% | -7.0% | -7.5% | -8.3% | -4.6% | -5.3% |
| AP | -11.0% | -12.7% | -6.5% | -6.5% | -11.0% | -11.0% |
| Total | +31.9% | +29.7% | +13.8% | +14.7% | +25.6% | +25.7% |

FA's proposed overall rate level change of +29.7% is higher than the indications we calculate based on these 8 scenarios; however, is only four points higher than Scenario G which also reflects the adjustment for current rate level inadequacy.

## Conclusion

All else being equal, if the Board approves a rate change in the range of +25%, FA's proposed rate change in its next rate application will be considerably less and closer to the annual trend rates. If the Board approves a rate change in the range of +14% to +18% (scenarios A, B, E or F), then FA's proposed rate change in its next rate application will additionally carry over 7 to 11 percentage points not approved in this rate application.

We believe that continued, large, rate increases alone are not an appropriate solution to this problem, and that consideration should be given to conducting a more in-depth study of the causes of this poor experience.

**Distribution and Use**

- This report was prepared for the sole use of the Newfoundland and Labrador 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.
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**Considerations and Limitations**

- For our review, we relied on data and information provided by FA 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 FA application and 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.

Please call us if you have any questions or require additional information.

Sincerely,

Paula L Elliott

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Theodore J. Zubulake, FCAS, FCIA