FACILITY Association

777 Bay Street, Suite 2400
P.O. Box 121
Toronto, Ontario
M5G 2C8

T: 416 863 1750
F: 416 868 0894
E: mail@facilityassociation.com

November 21, 2018

NL Board of Commissioners of Public Utility
120 Torbay Road
P.O. Box 21040
St. John's, NL
A1A 5B2

Attention: Cheryl Blundon, Board Secretary

RE: FA NL **Category 2 Taxis, Jitneys & Liveries Rate Application – OW PuBus Report of Findings** – Response to Report dated October 25, 2018

Dear Ms. Blundon,

Facility Association (FA) received a copy of the October 25, 2018 Oliver Wyman Report of Findings for the July 27, 2018 FA Category 2 Taxi Rate Application (the OW Report) with a request to provide comments (if any) to the Board of Commissioners, outlining the OW findings supporting rate change range from 4.6% rate increase to 3.4% rate decrease in contrast with our proposed 10.2% increase.

We appreciate the opportunity to comments on the Report prior to completion of your review. We have included further detail and discussion for the consideration of NL Board of Commissioners in relation to the OW Report's alternative estimates of ultimate, alternative HST adjustment factors, alternative complements of credibility, alternative servicing carriers fee expense provisions, and alternative provisions for premium financing, and why we consider our approaches and assumptions to be both reasonable and the preferred ones.

We continue to believe that our proposed rate change of +10.2% overall is appropriate and warranted and we are available to discuss the rate application at any time. We also believe that a more appropriate comparison indication based on alternative scenario A assumptions from the OW Report to be +5.9%, not +4.6%.

We believe that the NL Board of Commissioners should bear in mind that the FARM has experienced a recorded indemnity loss ratio (that is, prior to the inclusion of IBNR) over the last 10 accident years of 163%, and the associated ultimate indemnity loss ratios (that is, with the inclusion of IBNR) range from 142% to 291% and are 176% overall (our filing Exh D-1, column [7]). Over those 10 accident years, indemnity claims costs have exceeded earned premium (that is, have exceeded a 100% loss ratio) on average by $1,670 per taxi.

Taking a longer term view, over the 15 accident years from 2003 to 2017 inclusive to December 31, 2017, $33.6 million of claims payments have been made through the FARM for taxi policies in NL, compared with $26.8 million in premium earned over that period, a difference of $6.8 million. We estimate that an additional $10 million remains outstanding for claims for those accident years, meaning that the loss ratio for indemnity only over that 15 year period stands at 164%. On top of this must be

applied the expenses incurred by the insurance industry in supporting the issuance and management of those insurance policies and the associated claims.

All of this to say that there has been a clear and prolonged subsidy paid by the insurance industry to the taxi industry in NL over this period. (This ignores the larger subsidy from the insurance industry that applies to all automobile insurance consumers insured through the FARM because of the lack of a cost of capital provision being allowed in the FARM rates.)

Since 2012, FA has been actively engaged in reducing this subsidy with a succession of rate filings, the first of which was approved effective Aug 1, 2013. Over the period from this first rate increase, we estimate that rates have increased by approximately 240%, but a slower pace than the levels we have proposed. Each subsequent approved rate change by the NL Board of Commissioners vindicates, in our view, the prior FA proposed level, and the shortfall of premium since 2013 between FA's proposed rate change and the NL Board of Commissioners approved rate change has been over $2 million, perpetuating the subsidy. Further, had the NL Board of Commissioners approved rates as proposed, two of the six rate filings since 2013 would not likely have been submitted by FA (the March 2016 and the current rate filing).

FA has proposed an increase of +10.2% or $737 per taxi, in comparison with the OW Report estimate of +4.6% or $332 per taxi. Again, in our view, history / hindsight has repeatedly shown that the FA proposals have been appropriate, and we believe this will be borne out once again, and we ask the NL Board of Commissioners to recognize this and approve FA's proposal as is.

Ultimately, the Facility Association Board of Directors is responsible for our rate applications and, because of that; we will be providing our Board with a summary of the OW Report and our response in the coming week.

FA's role in the market place is to guarantee the availability of automobile insurance to those eligible to obtain it, acting as the "market of last resort". A healthy and competitive voluntary market keeps FA's size relatively small. For 2017, FA's share of the Newfoundland & Labrador taxi market premium was 92.2%, and the results of that premium is shared with the voluntary market. Importantly, rather than being a "market of last resort", FA currently (and has been for some time) the "market" for taxi insurance. It is important, in our view, that FA's rates are set to generate an appropriate return to ensure a properly functioning market, provide incentive for voluntary market participation in the provision of automobile insurance to taxis in Newfoundland & Labrador, and to provide an appropriate signal to taxi owners and operators of the risk profile they present, which is largely a factor of driving behaviours of operators (over the period 2008-2017, FARM NL taxi operators had TPL claims frequencies that were more than **6 to 8 times** higher than the industry private passenger and commercial vehicle frequencies).

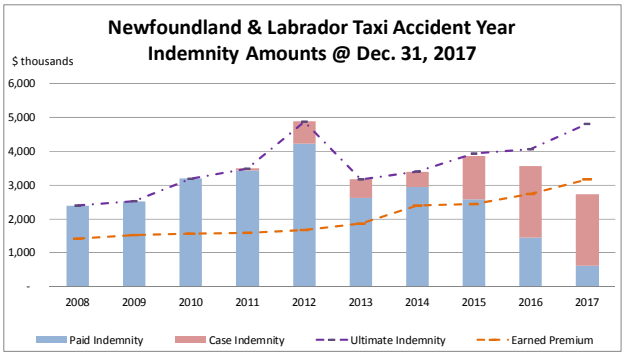
Best regards

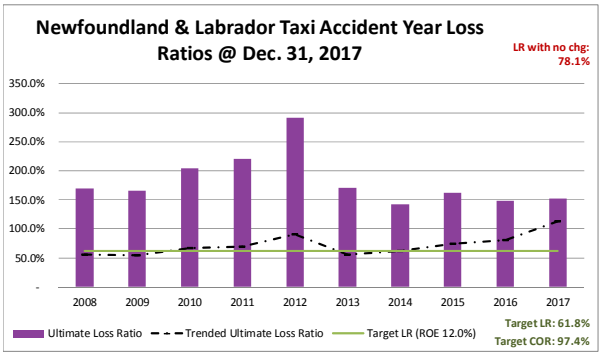
Shawn Doherty, FCAS, FCIA
SVP Actuarial & CFO

Newfoundland & Labrador Taxi Industry Experience

According to GISA's 2017 AIX data, taxi earned premium in 2017 accounted for 2.3% of total earned premium for Newfoundland & Labrador automobile, excluding individually-rated private passenger and farmer earned premium (i.e. "non-private passenger"). This percentage was also 2.3% for accident years 2013-2017 inclusive. Over that same period, the **recorded indemnity loss ratio** (i.e. **prior to IBNR**) was **105% for taxis**, compared with 59% for all non-private passenger. This was the highest recorded indemnity loss ratio of any non-private passenger rating class for 2013-2017 combined. As the FARM taxi results (which constitutes almost the entire taxi experience in Newfoundland & Labrador) are shared with the industry, inadequate rates have a significant (unfavourable) impact on members (who ultimately bear the financial impact of these results).

Over the 10 accident year period considered in the FA submission (AYs 2008-2017 inclusive) as at December 31, 2017, the FARM taxi ultimate indemnity loss ratios have ranged from a low of 142% to a high of 291%, with an average of 183% (weighted average of 176%), standard deviation of 45%, and a coefficient of variation of 25%, highlighting not only the high average ultimate loss ratio over the period (183%) but also the high level of relative variation (a 25% coefficient of variation). These results are summarized in the charts below.





At a target indemnity loss ratio of 62% over the period[1], the results suggest rates have been deficient by 184%, indicating a premium shortfall over that 10 accident year period of $37 million (even with the rate changes have been approved and earned), or approximately $48,700 for the roughly 760 taxis insured annually over that period. We would view this as a direct subsidy to the taxi industry from the insurance industry, and view such as inappropriate.

We have provided additional information summarized in tables on the next page, highlighting the NL FARM taxi experience over the 15 accident year period 2003-2017 inclusive.

[1]The target loss ratio is based on FA's profit provision including 12% ROE and FA estimated current risk-free yield.

Facility Association
NL Taxi Review
2018 Rate Filing

AY	annualized earned vehs [1]	($s) EP [2]	Indemnity only ($s) paid [3]	case [4]	recorded [5]	IBNR [6]	ultimate [7]	indemnity as % EP paid [6]	case [7]	recorded [8]	IBNR [9]	ultimate [10]
2003	652	1,259,006	1,267,082		1,267,082		1,267,082	100.6%	-	100.6%	-	100.6%
2004	749	1,342,716	1,417,194		1,417,194		1,417,194	105.5%	-	105.5%	-	105.5%
2005	628	1,316,495	1,107,007	72,255	1,179,262		1,179,262	84.1%	5.5%	89.6%	-	89.6%
2006	573	1,272,024	1,529,738		1,529,738		1,529,738	120.3%	-	120.3%	-	120.3%
2007	663	1,290,663	2,334,761		2,334,761		2,334,761	180.9%	-	180.9%	-	180.9%
2008	725	1,412,457	2,388,733		2,388,733		2,388,733	169.1%	-	169.1%	-	169.1%
2009	764	1,516,679	2,520,358		2,520,358		2,520,358	166.2%	-	166.2%	-	166.2%
2010	780	1,565,401	3,192,247		3,192,247		3,192,247	203.9%	-	203.9%	-	203.9%
2011	793	1,587,985	3,421,531	73,245	3,494,776		3,494,776	215.5%	4.6%	220.1%	-	220.1%
2012	816	1,676,159	4,227,610	650,391	4,878,001		4,878,001	252.2%	38.8%	291.0%	-	291.0%
2013	852	1,857,181	2,617,765	552,844	3,170,609	2,570	3,173,179	141.0%	29.8%	170.7%	0.1%	170.9%
2014	820	2,394,634	2,931,032	455,904	3,386,936	19,874	3,406,810	122.4%	19.0%	141.4%	0.8%	142.3%
2015	795	2,439,864	2,577,027	1,276,625	3,853,652	86,847	3,940,499	105.6%	52.3%	157.9%	3.6%	161.5%
2016	732	2,727,409	1,443,369	2,124,589	3,567,958	489,043	4,057,001	52.9%	77.9%	130.8%	17.9%	148.7%
2017	617	3,155,584	612,411	2,107,048	2,719,459	2,084,970	4,804,429	19.4%	66.8%	86.2%	66.1%	152.3%
15-yr tot	**10,959**	**26,814,257**	**33,587,865**	**7,312,901**	**40,900,766**	**2,683,304**	**43,584,070**	**125.3%**	**27.3%**	**152.5%**	**10.0%**	**162.5%**

unknown resolution to 2005 case

Facility Association
NL Taxi Review
2018 Rate Filing

AY	annualized earned vehs [1]	per vehicle amount ($s) EP [9]	paid [10]	recorded [11]	**ultimate [12]**	fitted [13]	residual [14]	yr-on-yr change in per vehicle amount (%) EP [15]	paid [16]	recorded [17]	ultimate [18]
2003	652	1,932	1,945	1,945	**1,945**	1,972	(27)				
2004	749	1,793	1,893	1,893	**1,893**	2,151	(258)	(7.2%)	(2.7%)	(2.7%)	(2.7%)
2005	628	2,096	1,762	1,877	**1,877**	2,348	(471)	16.9%	(6.9%)	(0.8%)	(0.8%)
2006	573	2,219	2,669	2,669	**2,669**	2,562	107	5.9%	51.5%	42.2%	42.2%
2007	663	1,946	3,521	3,521	**3,521**	2,795	726	(12.3%)	31.9%	31.9%	31.9%
2008	725	1,948	3,295	3,295	**3,295**	3,050	245	0.1%	(6.4%)	(6.4%)	(6.4%)
2009	764	1,985	3,299	3,299	**3,299**	3,328	(29)	1.9%	0.1%	0.1%	0.1%
2010	780	2,007	4,093	4,093	**4,093**	3,632	461	1.1%	24.1%	24.1%	24.1%
2011	793	2,003	4,315	4,407	**4,407**	3,963	444	(0.2%)	5.4%	7.7%	7.7%
2012	816	2,054	5,181	5,978	**5,978**	4,324	1,654	2.5%	20.1%	35.6%	35.6%
2013	852	2,180	3,072	3,721	**3,724**	4,718	(994)	6.1%	(40.7%)	(37.8%)	(37.7%)
2014	820	2,920	3,574	4,130	**4,155**	5,148	(993)	33.9%	16.3%	11.0%	11.6%
2015	795	3,069	3,242	4,847	**4,957**	5,618	(661)	5.1%	(9.3%)	17.4%	19.3%
2016	732	3,726	1,972	4,874	**5,542**	6,130	(588)	21.4%	(39.2%)	0.6%	11.8%
2017	617	5,114	993	4,408	**7,787**	6,689	1,098	37.3%	(49.6%)	(9.6%)	40.5%
15-yr tot	**10,959**	**2,447**	**3,065**	**667**	**3,732**	**245**	**3,977**	**7.2%**	**(4.7%)**	**6.0%**	**10.4%**

15-yr tot calculated as 2017 over 2003

To the extent that insurance policies written through the FARM do not provide an appropriate return on capital, insurer appetite for offering automobile insurance in Newfoundland & Labrador is negatively impacted, ultimately to the detriment of automobile insurance consumers (via lack of choice and the benefits of competition).

Facility Association Mission

By way of background, we have included the Facility Association mission statement below.

> *Facility Association's mission is to administer automobile insurance residual market mechanisms, enhance market stability, and guarantee the availability of automobile insurance to those eligible to obtain it. We strive to keep the market share of the residual markets as small as possible, so consumers may benefit from the competitive marketplace to the greatest extent possible.*

Our market share is largely based on two forces at work in the marketplace: the level of our rates relative to those of our members, and the appetite or willingness of companies to write business voluntarily. If our prices are below those of our member companies (assuming that companies have confidence in their own rates), our market share will be larger than it needs to be. We have seen that time and again in the jurisdictions we serve in Canada. As a market of last resort, our role is to always have our "door open" for consumers who find all other doors closed. It is inconsistent with our role for consumers to pass other open doors and come through ours because we have a lower price. In effect, that puts our member companies in competition with themselves, especially those companies whose business model is based on serving higher risk market segments.

Nova Scotia Consumer Advocate George Jordan captured much of the forgoing in his report released September 24, 2003:

> "*…FA's target is not to be in competition with the general market, and even to put itself out of business. Obviously, it ought not to be in competition with its members, who are subsidizing its costs, but apparently to some extent it is. Occasionally it will have rates lower than those of some companies specializing in higher risks, driving them out of the market with the result that many drivers who could have had other coverage end up in FA to their chagrin, if not to their cost.*"

The second force that impacts our market share is the appetite or willingness that companies have for writing business voluntarily. That appetite, if you will, is generally correlated with the belief companies each have in the adequacy of their own rates and the adequacy of the return on their capital, including the capital that supports Facility Association business.

We believe it is critical to our mission to ensure that FARM taxi rates are appropriately set, to provide incentive for voluntary market insurers to write the business and for operators to adjust their driving behaviours to help reduce their frequency of claims, and potentially the severity of claims, where collisions do occur.

Rate levels that are properly aligned with the "risk" level (i.e. aligned with relative levels of loss costs) provide incentive for those drivers that exhibit driving behaviours that are aligned with higher loss costs to alter those behaviours with a goal of reducing their premium, which benefits the greater society (in that the number traffic accidents might be reduced, and / or the severity of traffic accidents that occur may decrease). That is, relative rate / premium levels can act as a signaling mechanism to drivers in relation to their behaviours behind the wheel.

The FARM average annualized earned taxi count over the period 2008-2017 was approximately 760, compared with an industry private passenger average of 300,000 and commercial vehicle average of 25,000. That is, there are roughly 400 private passenger vehicles and 30 commercial vehicles for every taxi insured through the FARM in the province. **FARM taxis in Newfoundland & Labrador** over the period 2008-2017 **generated claims frequencies** that were 3.9 times higher than the industry private passenger / 6.0 times higher than commercial vehicles for **collision** coverage, and **6.3 times higher than the industry private passenger / 8.2 times higher than commercial vehicles for third party liability** coverage. These coverages are for claims arising from traffic accidents where the FARM taxi operator / policyholder was at fault. We believe it is reasonable that their premium levels should reflect this, and importantly, signal that their driving behaviours should be modified.

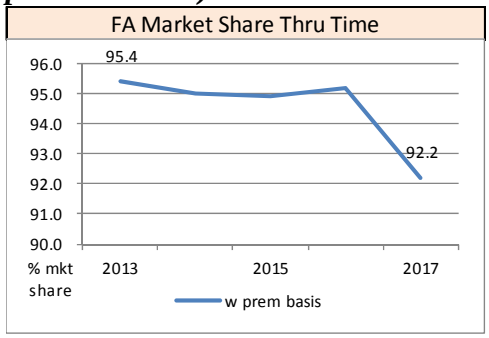
FA's analysis indicates that **the current rates will generate a -10% post-tax ROE for the policy period that was considered in our rate analysis**. It is important, we believe, for the NL Board of Commissioners to also recognize that all insurers in Newfoundland & Labrador writing non-private passenger business will be financially impacted by the rate adequacy of taxi drivers and operators insured through the FARM.

As stated earlier, to the extent that insurance policies written through the Facility Association do not provide an appropriate return on capital, insurer appetite for offering automobile insurance in Newfoundland & Labrador is negatively impacted, ultimately to the detriment of automobile insurance consumers (via lack of choice and the benefits of competition).

Facility Association Market Shares

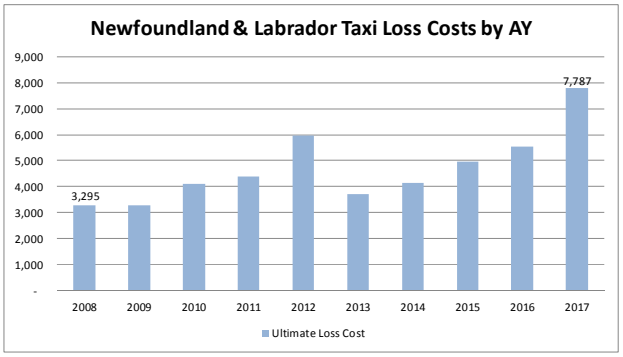
As previously stated, part of the Facility Association's mission is to keep the market share of the residual markets as small as possible. With respect to the taxi rating class in Newfoundland & Labrador, the Facility Association Residual Market (FARM) market share on a written premium basis decreased from 95.4% in 2013 to 92.2% in 2017, as indicated in the chart below.

FARM NL TX Market Share (written premium basis) over time



Source: 2017 AIX

FARM Volatility



Variations from one year to the next in underlying indemnity loss costs (chart at right) will cause associated indemnity loss ratios to fluctuate, all else being equal. The more volatility there is in the underlying indemnity loss costs, the more challenging it is to project future levels of loss costs. In this case, loss costs over the period have exhibited a coefficient of variation of 30% (i.e. the standard deviation of loss costs relative to the average loss cost over the period). To provide some perspective, the Newfoundland & Labrador industry private passenger indemnity only loss costs (FA ultimate selections) over the same period exhibited a coefficient of variation of 12%, while commercial vehicles exhibited a coefficient of variation of 4% (again, Newfoundland & Labrador industry indemnity only using FA ultimate selections).

Because the use of experience with significant process variance (i.e. random fluctuations) in individual accident year results can create instability in rate indications from one rate review to the next, it is imperative that credibility-weighting against an appropriate complement is used in the development of the rate indications. FA's approach to determining an appropriate complement is consistent across jurisdictions, rating classes, and has been consistent over time. We believe the FA approach is reasonable, balancing stability in rate indication determination from one period to the next, with responsiveness to changes in the underlying experience.

OW Report Finding Discussion

The October 25, 2018 Oliver Wyman ("OW") Report of Findings for Facility Association's July 2018 Category 2 taxi rate application (the "OW Report") contains 15 findings related to the rate level changes (listed in bullet form on pages 5 through 7), of which 5 (the selection of the ultimate loss amounts, the selected loss cost trend rates, the complement of credibility base, the expense provision, finance fee revenue, and HST rate change adjustment) are discussed in detail.

FA's proposed overall rate level change is +10.2%. Using alternative assumptions, OW has estimated rate indications range from +4.6% to -3.4% (see OW Report page 17 Table 6).

We have reviewed the OW Report and as per our usual practice, attempted to replicate the indication findings based on the alternative assumptions provided in the Report, as summarized in the tables that follow.

Indication Summary (%)	**OW Scenario A**		**FA**	
	change	ending indication	change	ending indication
FA Proposed		+10.2		10.2
Credibility Complement	-5.0	+5.2	-5.0	+5.2
NL Board's Guideline Loss Trend Rates	+2.3	+7.5	+2.2	+7.4
Board's HST adjustment	-0.7	+6.8	-0.5	+6.9
0.75% Finance Fee Revenue	-1.1	+5.7	-1.0	+5.9
Ending	**-4.5**	**+5.7**	**-4.3**	**+5.9**

Source: OW Report page 16 (Table 6 shows +4.6%); FA internal calculations

Indication Summary (%)	**OW Scenario B**		**FA**	
	change	ending indication	change	ending indication
FA Proposed		+10.2		10.2
OW Scenario A	-4.5	+5.7	-4.3	+5.9
Alternative Ultimates for BI and AccBen	-3.3	+2.4	-3.4	+2.5
Ending	**-7.8**	**+2.4**	**-7.7**	**+2.5**

Source: OW Report page 16 (Table 6 shows +1.3%); FA internal calculations

Indication Summary (%)	OW Scenario C		FA	
	change	ending indication	change	ending indication
FA Proposed		+10.2		10.2
OW Scenario B	-7.8	+2.4	-7.7	+2.5
Cap servicing carrier fee expense	-4.6	-2.2	-4.2	-1.7
Ending	**-12.4**	**-2.2**	**-11.9**	**-1.7**

Source: OW Report page 16 (Table 6 shows -3.4%); FA internal calculations

We were not able to reconcile the differences we have for the overall indications for scenario A, B and C presented in Table 6 of OW Report page 17, where the overall indication presented on Table 6 for Scenario A is +4.6%, Scenario B is +1.3%, and Scenario C is -3.4%.

Addressing Key Issues Found in the OW Report

For the remainder of this response, we provide comments on certain aspects of the OW Report. We believe the "key" issues raised can be viewed in 6 main categories as outlined below (7 key issues in total):

1. Selection of FARM Experience Ultimates (Bodily Injury)
2. Projection of Claims Costs
    a. Estimated trends
    b. HST adjustment
3. Complement of Credibility
4. Projection of Expenses
    a. Servicing Carrier provisions
    b. Offset for Premium Financing Fees

Through this final submission, we summarize the issues as we see them, and our responses.

Key Issue 1. *Selection of FARM Experience Ultimates (Bodily Injury)*

The OW Report states on page 9 "*FA's AA has greater insight into FA's claim experience and claim reserving practices than we do. And we don't presume that the AA's ultimate loss estimates are biased.*" The OW Report later states that, in relation to the ultimates for Bodily Injury (BI) for accident halves 2017-1 and 2017-2, the selection made by the FA's Appointed Actuary (AA) based on the "Weighted Method", is higher of the three results (Link Ratio Method, B-F Method, and Weighted Method). This is factually true, but, is consistent with the FA's AA valuation approach.

The AA currently takes into consideration ultimate estimates primarily from 5 methodologies, of which the 2 mentioned in the OW Report would be considered "weighted" approaches based on estimates from 2 other methodologies (expected LR method and link ratio method). In both cases, the "weighting" methodologies move from "expected" to the "link ratio" estimate over time (age).

The AA has established the "Weighted Method" based on the idea of a consistent linear transition from the a priori assumption for a specific accident period (the "expected" experience), and an updated estimate based on the link ratio method. By its nature, the link ratio method will take into account a form of "process variance" – that is, variance in a final ultimate from an "expected" level that can be attributed to randomness, whereas the "expected" experience does not. The weights selected by the FA's AA takes into account his view of level of recognition of process variance estimated by the link ratio methodology.

The B-F methodology is a similar weighting methodology (that is, weighting between an expected level of experience, and an updated link ratio estimate), but where the weights are derived from the link ratio assumptions used in the link ratio methodology.

In general for BI, the FA's AA selection process is based on a particular method for a particular age of development. For example, the FA's AA will, as a default, selected the Weighted Method for earlier ages, the B-F method for intermediate ages, and the link ratio thereafter. However, he will move off of these defaults where he feels appropriate. Generally, this will be where there appears to be large loss activity. In these cases, it is the general view that the link ratio method may overstate process variance in its estimate (in effect, the large claims will be "leveraged" by the selection of link ratio to ultimate), but at the same time, the expected loss ratio will understate what may be viewed as significant "known" process variance, and similarly, the Weighted Method may be viewed as potentially understating "known" process variance. As a result, the AA will take this (and other information) into account when making his final selections. Specifically, 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.

Key Issue 2a. *Projection of Claims Costs – Estimated Trends*

FA Discussion of Key Issue 2a.

The OW Report states on page 11 "*As presented in the table above, the CV loss cost trend rates selected by FA are lower than those selected by OW for Accident benefits, Uninsured Auto, and Comprehensive; and essentially the same for the other coverages.*"

The OW Report concludes on page 12: "*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. However, we continue to find the selected loss trend rates that we recommended to the Board as Guideline loss trend rates to be reasonable*".

There are several key aspects we wish to emphasize.

First, we do not select individual "trend rates" (or any other individual coefficient value), but rather, we selected a model that estimated coefficients, based on the design matrix of the model itself (i.e. the selected explanatory variables) and assuming a log-linear model form, and that errors are independently and individually distributed following a Normal distribution with a mean of zero and constant variance. This approach differs from the approach adopted by OW in their "industry trend benchmark" exercise, where trends themselves are selected, after review of the output of a number of regressions of various time periods / data.

Second, the FA final model selections for "frequency" and "severity" are not done in isolation, as the underlying goal is to fit loss costs – as a result, frequency and severity models are considered in tandem for final selections.

Third, while we have chosen to use a log-linear regression model form, there are many different modeling options available. Selection of the model form is a matter of judgment.

Fourth, we have chosen to model frequency and severity separately as we believe there is value in considering the modeling results across coverages and across rating classes where we believe correlation can be expected to exist. For example, traffic accidents potentially give rise to collision, DCPD, medical expense, disability income, death benefit, funeral expense, bodily injury, and tort-property damages claims. For multiple vehicle accidents, claims can arise across all such coverages at the same time. It is reasonable, in our view, to then consider claims frequency correlations across coverages affected by traffic accidents. Similarly, both collision and DCPD cover damage to vehicles involved in traffic accidents and we believe it is reasonable to consider claims severity correlations between these two coverages. Finally, traffic accidents are not strictly only between vehicles within the same "class" – private passenger vehicles can be involved in traffic accidents with commercial vehicles, motorcycles, taxis, etc. As such, we believe it is reasonable to consider claims frequency correlations for traffic accident coverages across rating classes.

Fifth and finally, there were some references in OW Report to "measures trends". As we indicated in our responses, we do not believe this is an accurate characterization of the process, as we are not "measuring" trends, but rather, we are modeling the correlated relationships, if any, between time /

seasonality and various "outcome variables" (frequency / severity / loss cost). The modeling process estimates relationships (in the form of "scalars" and "trends"), and provides uncertainty measures associated with the estimates. In our view, an estimate of a relationship differs from a "measurement" of a relationship. Importantly, the relationship estimates depend on the modeling form, and the model design.

We believe our entire process, our selected models, and the associated results are reasonable and should be considered in their entirety.

The OW Report notes in their report that substituting the benchmark trends for the FA trends increases the rate level indication (estimated by 2.3 points). We believe the NL Board of Commissioners should take this into account as part of the entire consideration of the FA proposed rate change relative to the OW alternatives.

Key Issue 2.b. *Projection of Claims Costs – HST*

FA Discussion of Key Issue 2.b.

The OW Report suggested an alternative estimate of the impact of the July 1, 2016 HST increase in relation to BI and AccBen, on the basis that much of the indemnification is not directly impacted. We have a different view, mainly in that there will be indirect impacts as the HST increase manifests itself in a one-time increase in inflation that can influence BI and AccBen settlement amounts. We believe our adjustment to be reasonable.

Key Issue 3. *Complement of Credibility*

FA Discussion of Key Issue 3.

The OW Report states on page 13: "*As stated in the Board's Decision A.I.4 (2017) regarding the FA prior taxi application, the Board did not accept that FA's adjustment for any rate inadequacy in its complement of credibility calculation. Similarly, as the Board found a rate increase of +18.6% to be supported in the prior filing…*"

While true, we believe the NL Board of Commissioners should reconsider their earlier findings with the benefit of hindsight. In particular, as summarized in the table at the top of the next page, each of the NL Board of Commissioners approved rate changes have subsequently been found to be significantly deficient. In this table, a "residual" indication for a filing is calculated by adjusting the filed for indication for the approved rate change, and this "residual" would be expected to be "carried over" to the next indication, assuming a consistent set of assumptions. There is no "residual" indication for the NL Board of Commissioners approved changes (the column titled "PUB Approved"). One would expect that subsequent rate approvals would be aligned with the net trend rate (estimated at less than 1%), but instead, each of the NL Board of Commissioners approved rates have been significantly higher than such a net trend, clearly indicating, in hindsight, a deficiency in prior decisions. We believe this should be recognized accounted for, as per our application. Of note, had the approvals matched FA's proposed changes, the FA "proposed changes" would have followed the indicated changes in the row "excess of prior residual" in the "FA Proposed Change" column, and it is likely that FA would not have needed to file the March 2016 and July 2018 filings.

Facility Association
NL Taxi Review
2018 Rate Filing

All indications / rate changes indicated are on an "all coverages" basis

		FA		OW Rpt	PUB	Residual Indication		
Filing Date	desciption	Indication	Proposed Change	Indication	Approved	FA Indication	FA Proposed	OW
Jan-13	as filed	66.4%	48.0%	48.6%	47.9%	12.5%	0.1%	0.5%
Mar-14	as filed	78.1%	53.9%	21.6%	19.3%	49.3%	29.0%	1.9%
	excess of prior residual	58.3%	53.7%	21.0%	19.3%			
May-15	as filed	108.7%	74.1%	28.9%	28.9%	61.9%	35.1%	-
	excess of prior residual	39.8%	35.0%	26.5%	28.9%			
Mar-16	as filed	79.7%	27.4%	25.4%	25.7%	43.0%	1.4%	(0.2%)
	excess of prior residual	11.0%	(5.7%)	25.4%	25.7%			
Dec-16	as filed	56.6%	29.7%	18.1%	18.6%	32.0%	9.4%	(0.4%)
	excess of prior residual	9.5%	27.9%	18.3%	18.6%			
Jul-18	as filed	26.3%	10.2%	4.6%		26.3%	10.2%	4.6%
	excess of prior residual	(4.3%)	0.7%	5.0%				

In our rate indication process, the credibility-weighted projected loss ratio (LR) is a best estimate of the projection period LR, being derived from a weighting of two potential indicators of that LR. The first potential indicator is based on our final selection from the previous analysis (the “base line” projected LR used as the complement of credibility in the weighting process). The second is based on the most recent five years of experience. From one annual review to the next, these will get updated to lead us toward the “true underlying” LR. How long it takes to reach a “steady state” will depend on the difference between the ratios, and where the “true underlying” LR lies. Furthermore, there is potential that the change in the projected LR from this credibility weighting process from one period to the next would not be consistent with an assumption that the projected claims cost increase only in relation to trend. This is particularly relevant where there is a significant difference in the “base line” projected loss ratio (that is, the initial assumption of the projected loss ratio, determined from the previous analysis, taking into account approved rate changes since the last analysis, and net trends between the average accident periods associated with the two reviews). In the case of FA’s NL Taxi review, this is certainly the case, as summarized in the table at the top of the next page (taken from the filing’s Exhibit C-1).

Derivation of Indicated Change in Overall Rate Level - 2018Q2			[A]	[F]	[G]
($1s) unless otherwise indicated			Third Party Liability	Accident Benefits	Uninsured Automobile
Updated Projected Loss Ratio (indemnity only, nominal) @ Current Rates					
[7]	Updated projected loss ratio (indemnity only, nominal), prior analysis	Exh C-2, row [14]	80.6%	77.9%	80.4%
Projected Loss Ratio (indemnity only, nominal) based on FA experience					
[8]	FA projected ultimate loss ratio (indemnity only, nominal)	Exh D-1, col [17]	76.0%	75.0%	103.8%
Credibility-Weighted Projected Loss Ratio (indemnity only, nominal)					
[9]	FA experience credibility	Exh E-1, col [8]		31.3%	11.6%
[10]	Credibility-weighted projected Loss Ratio (indeminty only, nominal)	=[8]*[9]+[7]*(1-[9])	78.3%	77.0%	83.1%

It is easiest to show this through illustration. For this, we show below 3 "potential futures" of results of our "future" analyses[2] for each of TPL, AccBen, and UA. Under the first future, the experience period is updated annually, replacing the oldest accident year used in the previous analysis with the newest available accident year (for instance, for the June 1, 2019 effective date review, accident year 2011 and 2-12 are dropped and accident year 2016 and 2017 is added). The future rate level indications depend critically on the "path" the new experience years take – will they be consistent with the "base line" loss ratios shown in row [7] of the table above? Or the 2008-2012 experience LRs shown in row [8]? Or perhaps the credibility-weighted LR in row [10]? We look at each in turn below.

TPL

Key Assumptions for Potential Future Indications are summarized below and used in the example.

Facility Association Residual Market (FARM)
NL Taxi 2018Q2 Indication
Potential Future Indications

TPL	net trend:	0.5%	experience credibility: 49.6%	target LR consistent with 0 CoC:	68.7%
				max proposed change:	14.0%

The above key assumptions are used under each of the 3 Potential Future Indication determinations discussed below.

Potential Future 1: Accident Years 2019 onward have experience LR consistent with Jun,1,2019 base line projected LR

Effective for	period index	base line projected LR	experience projected LR	cred wghted projected LR	indication	approved / proposed	LR post rate chg	accumulative rate factor
1-Jun-19		80.6%	76.0%	78.3%	14.0%	10.5%	70.9%	110.5%
1-Jun-20	1	71.3%	70.0%	70.7%	2.9%	2.9%	68.7%	113.7%
1-Jun-21	2	69.0%	69.1%	69.0%	0.4%	0.4%	68.7%	114.2%
1-Jun-22	3	69.0%	70.0%	69.5%	1.2%	1.2%	68.7%	115.6%
1-Jun-23	4	69.0%	70.3%	69.6%	1.3%	1.3%	68.7%	117.1%
1-Jun-24	5	69.0%	70.6%	69.8%	1.6%	1.6%	68.7%	119.0%
1-Jun-25	6	69.0%	69.8%	69.4%	1.0%	1.0%	68.7%	120.2%
1-Jun-26	7	69.0%	69.4%	69.2%	0.7%	0.7%	68.7%	121.0%
1-Jun-27	8	69.0%	69.3%	69.1%	0.6%	0.6%	68.7%	121.7%
1-Jun-28	9	69.0%	69.3%	69.1%	0.6%	0.6%	68.7%	122.4%
1-Jun-29	10	69.0%	69.2%	69.1%	0.6%	0.6%	68.7%	123.1%
1-Jun-30	11	69.0%	69.2%	69.1%	0.6%	0.6%	68.7%	123.8%
1-Jun-31	12	69.0%	69.1%	69.0%	0.4%	0.4%	68.7%	124.3%

[2] For this exercise, we keep all other assumptions unchanged to focus attention on future indications as future "experience" rolls in.

The first potential future summarized above has accident years 2019 and beyond with loss costs consistent with those considered the "base line" in our current review. Note that the indication shown for next year (June 1, 2020 effective) is not 0.5% (the net trend) but instead 2.9% assuming the proposed rate change of +10.5% would be approved; if OW Report indication of +5.7% was approved then the next year indication would be +7.4%. Part of this is in recognition that we do not take the full indication for rates effective June 1, 2019 (and so the "base line" projected for June 1, 2020 is higher than 69.0% - the target LR adjusted for net trend).

Also note, however, that the indications do not reach "steady state" at 0.5% (the net trend) until 7-years out. This is due to the credibility-weighting impact, as we "flush out" the "unrepresentative experience period" and rely solely on accident years 2019 and later (which, by assumption, were set consistent with the June 1, 2019 base line projected LR). Further, it doesn't happen as soon as we are only using 2019 and later years – because the "drag" caused by the base line projected LR – in effect, we would overshoot" the indications early on (again, assuming the future accident years are as per the underlying assumption described above).

If the prior NL Board of Commissioners approved rate was adequate, then the next indication for this scenario would be the net trend, but the fact is the net trend would be reached in 7 years.

Potential Future 1: Accident Years 2019 onward have experience LR consistent with Jun,1,2019 experience projected LR

Effective for	period index	base line projected LR	experience projected LR	cred wghted projected LR	indication	approved / proposed	LR post rate chg	accumulative rate factor
1-Jun-19		80.6%	76.0%	78.3%	14.0%	10.5%	70.9%	110.5%
1-Jun-20	1	71.3%	69.1%	70.2%	2.2%	2.2%	68.7%	112.9%
1-Jun-21	2	69.0%	68.0%	68.5%	(0.3%)	(0.3%)	68.7%	112.6%
1-Jun-22	3	69.0%	68.5%	68.8%	0.1%	0.1%	68.7%	112.7%
1-Jun-23	4	69.0%	68.8%	68.9%	0.3%	0.3%	68.7%	113.0%
1-Jun-24	5	69.0%	69.0%	69.0%	0.4%	0.4%	68.7%	113.5%
1-Jun-25	6	69.0%	69.0%	69.0%	0.4%	0.4%	68.7%	114.0%
1-Jun-26	7	69.0%	69.0%	69.0%	0.4%	0.4%	68.7%	114.5%
1-Jun-27	8	69.0%	69.1%	69.0%	0.4%	0.4%	68.7%	115.0%
1-Jun-28	9	69.0%	69.1%	69.0%	0.4%	0.4%	68.7%	115.5%
1-Jun-29	10	69.0%	69.2%	69.1%	0.6%	0.6%	68.7%	116.2%
1-Jun-30	11	69.0%	69.1%	69.0%	0.4%	0.4%	68.7%	116.7%
1-Jun-31	12	69.0%	69.1%	69.0%	0.4%	0.4%	68.7%	117.2%

Under this second scenario (summarized in the table above), accident years 2019 and beyond have loss costs consistent with those considered the "experience" in our current review. Like the first scenario, the indication shown for next year (June 1, 2020 effective) is +2.2% assuming the proposed rate change of +10.5% would be approved.

Here, the "steady state" is reached sooner as the base line and experience LRs don't "cross" over time.

Potential Future 1: Accident Years 2019 onward have experience LR consistent with Jun,1,2019 cred wghted projected LR

Effective for	period index	base line projected LR	experience projected LR	cred wghted projected LR	indication	approved / proposed	LR post rate chg	accumulative rate factor
1-Jun-19		80.6%	76.0%	78.3%	14.0%	10.5%	70.9%	110.5%
1-Jun-20	1	71.3%	69.5%	70.4%	2.5%	2.5%	68.7%	113.3%
1-Jun-21	2	69.0%	68.6%	68.8%	0.1%	0.1%	68.7%	113.4%
1-Jun-22	3	69.0%	69.3%	69.1%	0.6%	0.6%	68.7%	114.1%
1-Jun-23	4	69.0%	69.6%	69.3%	0.9%	0.9%	68.7%	115.1%
1-Jun-24	5	69.0%	69.7%	69.3%	0.9%	0.9%	68.7%	116.1%
1-Jun-25	6	69.0%	69.5%	69.2%	0.7%	0.7%	68.7%	116.9%
1-Jun-26	7	69.0%	69.4%	69.2%	0.7%	0.7%	68.7%	117.7%
1-Jun-27	8	69.0%	69.2%	69.1%	0.6%	0.6%	68.7%	118.4%
1-Jun-28	9	69.0%	69.2%	69.1%	0.6%	0.6%	68.7%	119.1%
1-Jun-29	10	69.0%	69.1%	69.0%	0.4%	0.4%	68.7%	119.6%
1-Jun-30	11	69.0%	69.2%	69.1%	0.6%	0.6%	68.7%	120.3%
1-Jun-31	12	69.0%	69.1%	69.0%	0.4%	0.4%	68.7%	120.8%

Under this third scenario (summarized in the table above), accident years 2019 and beyond have loss costs consistent with those considered the "credibility-weighted" in our current review (this is the "best estimate" scenario). Like the first two scenarios, the indication shown for next year (June 1, 2020 effective) is not 0.5% (the net trend) but instead +2.5% - not surprisingly, it falls between that indicated under section 1 and 2.

Here, the "steady state" is reached late like scenario 1, as the base line and experience LRs "cross" after a few periods, causing an "over-shoot" of the changes.

All of the above simply highlights that there is not necessarily a "clear-path" to the "final" indication at an annual "net trend" steady state level. Obviously, there are myriad changes that occur impacting other assumptions that would also impact future indications – again, the focus here was only in relation to a specific set of potential loss ratios for accident years 2019 onward.

We include similar tables for Accident Benefits (AccBen) and Uninsured Automobile (UA) over the next several pages. Here, the "steady-state" is much further out, as the experience credibility is so much lower.

AccBen

Key Assumptions for Potential Future Indications are summarized below and used in the example.

Facility Association Residual Market (FARM)
NL Taxi 2018Q2 Indication
Potential Future Indications

AccBen	net trend: 0.0%	experience credibility: 31.3%	target LR consistent with 0 CoC: 70.3%
			max proposed change: 9.5%

The above key assumptions are used under each of the 3 Potential Future Indication determinations discussed below.

Potential Future 1: Accident Years 2019 onward have experience LR consistent with Jun,1,2019 base line projected LR

Effective for	period index	base line projected LR	experience projected LR	cred wghted projected LR	indication	approved / proposed	LR post rate chg	accumulative rate factor
1-Jun-19		77.9%	75.0%	77.0%	9.5%	7.1%	71.9%	107.1%
1-Jun-20	1	71.9%	70.6%	71.5%	1.7%	1.7%	70.3%	108.9%
1-Jun-21	2	70.3%	69.9%	70.2%	(0.1%)	(0.1%)	70.3%	108.8%
1-Jun-22	3	70.3%	70.5%	70.4%	0.1%	0.1%	70.3%	108.9%
1-Jun-23	4	70.3%	71.0%	70.5%	0.3%	0.3%	70.3%	109.2%
1-Jun-24	5	70.3%	71.3%	70.6%	0.4%	0.4%	70.3%	109.6%
1-Jun-25	6	70.3%	71.1%	70.6%	0.4%	0.4%	70.3%	110.0%
1-Jun-26	7	70.3%	70.8%	70.5%	0.3%	0.3%	70.3%	110.3%
1-Jun-27	8	70.3%	70.6%	70.4%	0.1%	0.1%	70.3%	110.4%
1-Jun-28	9	70.3%	70.6%	70.4%	0.1%	0.1%	70.3%	110.5%
1-Jun-29	10	70.3%	70.5%	70.4%	0.1%	0.1%	70.3%	110.6%
1-Jun-30	11	70.3%	70.4%	70.3%	-	-	70.3%	110.6%
1-Jun-31	12	70.3%	70.4%	70.3%	-	-	70.3%	110.6%

Potential Future 1: Accident Years 2019 onward have experience LR consistent with Jun,1,2019 experience projected LR

Effective for	period index	base line projected LR	experience projected LR	cred wghted projected LR	indication	approved / proposed	LR post rate chg	accumulative rate factor
1-Jun-19		77.9%	75.0%	77.0%	9.5%	7.1%	71.9%	107.1%
1-Jun-20	1	71.9%	70.0%	71.3%	1.4%	1.4%	70.3%	108.6%
1-Jun-21	2	70.3%	69.1%	69.9%	(0.6%)	(0.6%)	70.3%	107.9%
1-Jun-22	3	70.3%	69.5%	70.0%	(0.4%)	(0.4%)	70.3%	107.5%
1-Jun-23	4	70.3%	69.8%	70.1%	(0.3%)	(0.3%)	70.3%	107.2%
1-Jun-24	5	70.3%	70.0%	70.2%	(0.1%)	(0.1%)	70.3%	107.1%
1-Jun-25	6	70.3%	70.0%	70.2%	(0.1%)	(0.1%)	70.3%	107.0%
1-Jun-26	7	70.3%	70.1%	70.2%	(0.1%)	(0.1%)	70.3%	106.9%
1-Jun-27	8	70.3%	70.2%	70.3%	-	-	70.3%	106.9%
1-Jun-28	9	70.3%	70.2%	70.3%	-	-	70.3%	106.9%
1-Jun-29	10	70.3%	70.2%	70.3%	-	-	70.3%	106.9%
1-Jun-30	11	70.3%	70.2%	70.3%	-	-	70.3%	106.9%
1-Jun-31	12	70.3%	70.2%	70.3%	-	-	70.3%	106.9%

Potential Future 1: Accident Years 2019 onward have experience LR consistent with Jun,1,2019 cred wghted projected LR

Effective for	period index	base line projected LR	experience projected LR	cred wghted projected LR	indication	approved / proposed	LR post rate chg	accumulative rate factor
1-Jun-19		77.9%	75.0%	77.0%	9.5%	7.1%	71.9%	107.1%
1-Jun-20	1	71.9%	70.4%	71.4%	1.6%	1.6%	70.3%	108.8%
1-Jun-21	2	70.3%	69.7%	70.1%	(0.3%)	(0.3%)	70.3%	108.5%
1-Jun-22	3	70.3%	70.2%	70.3%	-	-	70.3%	108.5%
1-Jun-23	4	70.3%	70.6%	70.4%	0.1%	0.1%	70.3%	108.6%
1-Jun-24	5	70.3%	70.9%	70.5%	0.3%	0.3%	70.3%	108.9%
1-Jun-25	6	70.3%	70.7%	70.4%	0.1%	0.1%	70.3%	109.0%
1-Jun-26	7	70.3%	70.6%	70.4%	0.1%	0.1%	70.3%	109.1%
1-Jun-27	8	70.3%	70.6%	70.4%	0.1%	0.1%	70.3%	109.2%
1-Jun-28	9	70.3%	70.5%	70.4%	0.1%	0.1%	70.3%	109.3%
1-Jun-29	10	70.3%	70.4%	70.3%	-	-	70.3%	109.3%
1-Jun-30	11	70.3%	70.4%	70.3%	-	-	70.3%	109.3%
1-Jun-31	12	70.3%	70.4%	70.3%	-	-	70.3%	109.3%

UA

Key Assumptions for Potential Future Indications are summarized below and used in the example.

Facility Association Residual Market (FARM)
NL Taxi 2018Q2 Indication
Potential Future Indications

UA net trend: 0.0% experience credibility: 11.6% target LR consistent with 0 CoC: 70.4%
max proposed change: 18.0%

Potential Future 1: Accident Years 2019 onward have experience LR consistent with Jun,1,2019 base line projected LR

Effective for	period index	base line projected LR	experience projected LR	cred wghted projected LR	indication	approved / proposed	LR post rate chg	accumulative rate factor
1-Jun-19		80.4%	103.8%	83.1%	18.0%	15.2%	72.1%	115.2%
1-Jun-20	1	72.1%	86.0%	73.7%	4.7%	4.7%	70.4%	120.6%
1-Jun-21	2	70.4%	78.3%	71.3%	1.3%	1.3%	70.4%	122.2%
1-Jun-22	3	70.4%	73.5%	70.8%	0.6%	0.6%	70.4%	122.9%
1-Jun-23	4	70.4%	69.2%	70.3%	(0.1%)	(0.1%)	70.4%	122.8%
1-Jun-24	5	70.4%	65.5%	69.8%	(0.9%)	(0.9%)	70.4%	121.7%
1-Jun-25	6	70.4%	66.1%	69.9%	(0.7%)	(0.7%)	70.4%	120.8%
1-Jun-26	7	70.4%	66.6%	70.0%	(0.6%)	(0.6%)	70.4%	120.1%
1-Jun-27	8	70.4%	66.9%	70.0%	(0.6%)	(0.6%)	70.4%	119.4%
1-Jun-28	9	70.4%	67.3%	70.0%	(0.6%)	(0.6%)	70.4%	118.7%
1-Jun-29	10	70.4%	67.7%	70.1%	(0.4%)	(0.4%)	70.4%	118.2%
1-Jun-30	11	70.4%	68.0%	70.1%	(0.4%)	(0.4%)	70.4%	117.7%
1-Jun-31	12	70.4%	68.3%	70.2%	(0.3%)	(0.3%)	70.4%	117.3%

Potential Future 1: Accident Years 2019 onward have experience LR consistent with Jun,1,2019 experience projected LR

Effective for	period index	base line projected LR	experience projected LR	cred wghted projected LR	indication	approved / proposed	LR post rate chg	accumulative rate factor
1-Jun-19		80.4%	103.8%	83.1%	18.0%	15.2%	72.1%	115.2%
1-Jun-20	1	72.1%	90.1%	74.2%	5.4%	5.4%	70.4%	121.4%
1-Jun-21	2	70.4%	85.5%	72.2%	2.6%	2.6%	70.4%	124.6%
1-Jun-22	3	70.4%	83.3%	71.9%	2.1%	2.1%	70.4%	127.2%
1-Jun-23	4	70.4%	81.6%	71.7%	1.8%	1.8%	70.4%	129.5%
1-Jun-24	5	70.4%	80.2%	71.5%	1.6%	1.6%	70.4%	131.6%
1-Jun-25	6	70.4%	78.9%	71.4%	1.4%	1.4%	70.4%	133.4%
1-Jun-26	7	70.4%	77.8%	71.3%	1.3%	1.3%	70.4%	135.1%
1-Jun-27	8	70.4%	76.8%	71.1%	1.0%	1.0%	70.4%	136.5%
1-Jun-28	9	70.4%	76.0%	71.0%	0.9%	0.9%	70.4%	137.7%
1-Jun-29	10	70.4%	75.4%	71.0%	0.9%	0.9%	70.4%	138.9%
1-Jun-30	11	70.4%	74.7%	70.9%	0.7%	0.7%	70.4%	139.9%
1-Jun-31	12	70.4%	74.2%	70.8%	0.6%	0.6%	70.4%	140.7%

Potential Future 1: Accident Years 2019 onward have experience LR consistent with Jun,1,2019 cred wghted projected LR

Effective for	period index	base line projected LR	experience projected LR	cred wghted projected LR	indication	approved / proposed	LR post rate chg	accumulative rate factor
1-Jun-19		80.4%	103.8%	83.1%	18.0%	15.2%	72.1%	115.2%
1-Jun-20	1	72.1%	86.5%	73.8%	4.8%	4.8%	70.4%	120.7%
1-Jun-21	2	70.4%	79.1%	71.4%	1.4%	1.4%	70.4%	122.4%
1-Jun-22	3	70.4%	74.7%	70.9%	0.7%	0.7%	70.4%	123.3%
1-Jun-23	4	70.4%	70.8%	70.4%	-	-	70.4%	123.3%
1-Jun-24	5	70.4%	67.4%	70.1%	(0.4%)	(0.4%)	70.4%	122.8%
1-Jun-25	6	70.4%	67.7%	70.1%	(0.4%)	(0.4%)	70.4%	122.3%
1-Jun-26	7	70.4%	67.9%	70.1%	(0.4%)	(0.4%)	70.4%	121.8%
1-Jun-27	8	70.4%	68.2%	70.1%	(0.4%)	(0.4%)	70.4%	121.3%
1-Jun-28	9	70.4%	68.5%	70.2%	(0.3%)	(0.3%)	70.4%	120.9%
1-Jun-29	10	70.4%	68.7%	70.2%	(0.3%)	(0.3%)	70.4%	120.5%
1-Jun-30	11	70.4%	69.0%	70.2%	(0.3%)	(0.3%)	70.4%	120.1%
1-Jun-31	12	70.4%	69.2%	70.3%	(0.1%)	(0.1%)	70.4%	120.0%

We believe the preceding charts clearly show that the prior approved rates were not adequate, and we believe our complement of credibility to be reasonable.

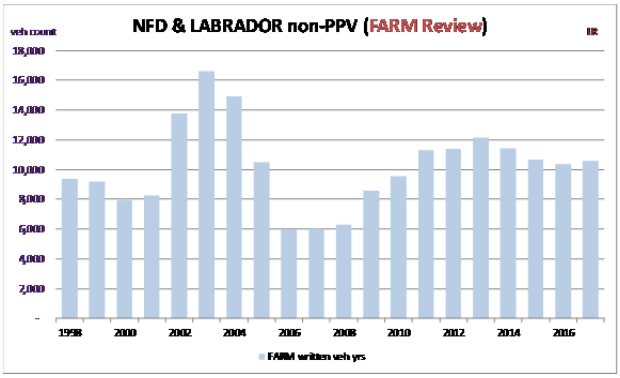
Key Issue 4a. *Projection of Expense – Servicing Carrier Compensation (excluding claims expenses)*

FA Discussion of Key Issue 4a.

The OW Report suggests that the provision related to Servicing Carriers compensation for non-claims expense amount should be capped based on an estimate of "actual" costs incurred by Servicing Carriers in New Brunswick / Nova Scotia in providing underwriting, rating, broker management, and general administrative activities related to underwriting and issuing automobile insurance policies on behalf of the FARM. This view assumes that Servicing Carriers ought not to be allowed a provision for profit for providing such services, although no reason is provided for this stance.

To be clear, Servicing Carriers are acting as an intermediary, commissioned by FA to perform certain tasks on the behalf of FA. For these services, Servicing Carriers are compensated via the methodology and levels as laid out in the Facility Association Plan of Operation, having the force of law. The FA submission reflects these actual, legally binding costs, in its expense assumption provision, on behalf its members, who are "joint and severally" responsible for the insurance contract obligations arising through the FARM.

There are other options that FA could have taken in order to be able to underwrite and issue automobile insurance contracts in Newfoundland & Labrador. In particular, rather than outsourcing these activities to member companies to act as Servicing Carriers (leveraging their people, processes, and systems), FA could have outsourced to a separate and independent third party. Alternatively, FA could have set up the entire underwriting, broker management, and policy issuance / maintenance processes in-house, hiring the necessary staff, establishing the necessary processes, and developing and maintaining the necessary systems, and ensuring the appropriate level of redundancy in order to be able to handle a sudden surge in FARM volume such as was experienced in Newfoundland & Labrador between 2002 to 2005 (as an example, see FARM NL private passenger volumes in the chart to the right). However, both of these alternative options would be, in our view, substantially more expensive than the current out-sourcing model.



FA management believes that the current Servicing Carrier compensation model is appropriate and allows for flexibility where volumes change rapidly as can (and does occur) from time to time. Further, while FA does from time to time have inquiries from members considering becoming Servicing Carriers, none have actually done so in a significant period, suggesting that the current compensation is not particularly attractive to a for profit enterprise.

This leads to our last point, which is that the Servicing Carriers are for-profit enterprises, providing a valuable service to FA and to insurance consumers in Newfoundland & Labrador in a cost effective way. They should be allowed a non-zero return for the services they provide, as they do take on risk in providing those services. We believe the compensation program properly reflects their costs, an

appropriate profit level, and the value that they bring. We believe it is appropriate to include their costs as provisions in the rate program consistent with how they will be actually paid as required under the Plan of Operation, and that the recommended "capping" suggested in the OW Report should not be pursued.

Key Issue 4b. *Projection of Expense – Offset – Premium Financing Fees*

FA Discussion of Key Issue 4b.

Premium financing fee revenue collected by Servicing Carriers are not considered in the FA assumption set (i.e. there is no consideration for a reduction to the variable expense provision to reflect the fee revenue net of costs and profit provision). Our support for this position is provided in detail in section 2.f.2 under "*Premium Variable Expenses, excluding claims fees (Variable)*" (pages 31 to 33) of the Actuarial Support section of our filing submission.

Premium financing fees are charged to reflect returns to capital providers in relation to the risk presented. Returns, by definition, are cash flows after taking into consideration costs, where risks reflect the uncertainty of the cash flows, and the amount of capital to support the "service" reflects the acceptable level of default of the capital provider, due to losses incurred in providing the "service".

In this particular case, the "service" is effectively the provision of a loan to a policyholder in the amount of the insurance policy premium, with loan repayment scheduled over the course of the policy term. The direct costs incurred by the loan provider include the direct costs of administering the program, and the uncertainty of the cash flows reflect the credit risk that is borne by the loan provider (i.e. that the loan is not repaid either on time, or completely).

To get a ***sense*** for the level of capital required to support the service, one might consider OSFI's Minimum Capital Test (MCT). Currently, "instalment" premium is a receivable in the OSFI P&C financial return described as "*Policy premiums that are payable over several periods (multiple payments and instalments)* …" and are to be recorded on line 22 of page 20.10 (Assets) of the OSFI return. Per the 2016 MCT Guideline Chapter 6 (Credit Risk), a risk margin of 5% is applicable to instalment premium receivables outstanding less than 60 days, and a 10% risk margin is applicable to instalment premium receivable outstanding 60 days or more.

Based on this direction, one might assume such a risk margin approach could be applied to "loans" provided in support of premium financing arrangements. On this basis and assuming 12-month insurance policy terms, the average margin would be 9.2%, applicable to the "loan" balance. This margin generates the "minimum" capital level – while the level of capital relative to the minimum is up to the individual insurer, 2 times the minimum level is common. This would imply a capital level of around 18% of the loan balance. Assuming a 12% post-tax ROE (17% pre-tax), this rough calculation suggests that the return to the capital provider should be approximately 3% of the policy premium (18% x 17%).

To be absolutely clear on this, we are NOT stating in the above that the MCT loadings for instalment premiums would necessarily directly apply to this situation. We are simply stating that this is a way to get a **SENSE** for the capital level required to support providing loans. A more direct approach would be to look to OSFI's capital requirements for banks or other lending institutions. We opted not to do so simply for convenience. We believe the result would be the same – providing loans requires capital, it is simply a matter of estimating the amount of capital required. We believe the above is a reasonable

back-of-the-envelope approach. However, we're sure that actual providers of such loans may have a more refined approach.

As stated earlier, FA's indication does not include any consideration at all for premium financing because 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. However, if it were to be included (that is, if premium financing fee revenue were to be included as part of the determination of the overall indications), the following adjustments would also have to be made to ensure consistency in the revenue, return, and capital related to premium financing:

i. supporting capital and the return on that capital needs to be formally included (as per above, we believe it is reasonable to assume 3% of policy premium as an appropriate return pre-tax);

ii. premium cash flow assumptions need to be altered to reflect "later" collection of cash (cash flows impact investment income – as later collection of premium reduces investment income, all else equal);

iii. the administrative costs assumption needs to be increased; and

iv. a provision for "bad debt" (i.e. credit loss) needs to be included (that is, an estimate of the long-term average credit loss – i.e. premium related to a policy period exposure that is ultimately not collected – so that coverage is provided during that period but no premium was paid).

We believe it is reasonable to assume that the current premium financing fees charged by the Servicing Carriers (collectively) appropriately reflect all of the above, such that the fees that are paid approximately cover administrative costs, expected long-term credit losses, and returns on the capital required to support the service of financing premium. Policyholders have other options for financing their annual premium, including but not limited to credit cards (i.e. paying the annual premium using their credit card, and paying the balance over the course of the year), accessing secured or unsecured lines of credit, or directly from a premium financing company. Some of these options, we believe, would ultimately be more costly (particularly the credit card option).

As a result, we do NOT believe that the premium financing fee revenue collected by Servicing Carriers should be used to reduce the variable expense provision. However, if such an adjustment were to be made, it is important to ensure that the 4 items addressed above are also reflected in the determination of such an adjustment.