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December 4, 2019

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 Taxi Report of Findings** – Response to Report dated November 26, 2019

Dear Ms. Blundon,

Facility Association (FA) received a copy of the November 26, 2019 Oliver Wyman Report of Findings for the September 16, 2019 FA Category 2 Taxi Rate Application (the OW Report). We were also asked to provide comments (if any) to the Board of Commissioners, outlining the OW findings supporting rate change range from 0.3% rate increase to 2.1% rate decrease in contrast with our proposed 3.9% increase.

We appreciate the opportunity to provide 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 loss trend rates, alternative complements of credibility, 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 +3.9% overall is appropriate and warranted and we are available to discuss the rate application at any time.

We believe it is also important to stress to the NL Board of Commissioners that, in addition to getting some (relatively minor) rate relief, the **primary focus of our current filing is to create some separation in rates by rating territory** (we now differentiate among 3 rating territories) **and by driving record** (with the expansion of driving record to include 4 and 5). We believe these changes reflect differences that the taxi industry would find welcome and appropriate.

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 155%, and the associated ultimate indemnity loss ratios (that is, with the inclusion of IBNR) range from 95% to 278% and are 161% 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 $1,610 per taxi.

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 300%, 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 $3 million, perpetuating the subsidy.

FA has proposed an increase of +3.9% or $297 per taxi, in comparison with the OW Report estimate of +0.3% or $23 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 2018, FA's share of the Newfoundland & Labrador taxi market premium was 91.7%, 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. In particular, their risk profile is largely a factor of driving behaviours of operators or perhaps more generally a nature result of the taxi business (over the period 2009-2018, 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).

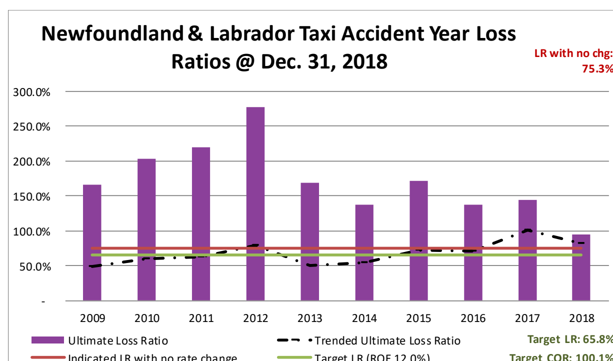
Best regards

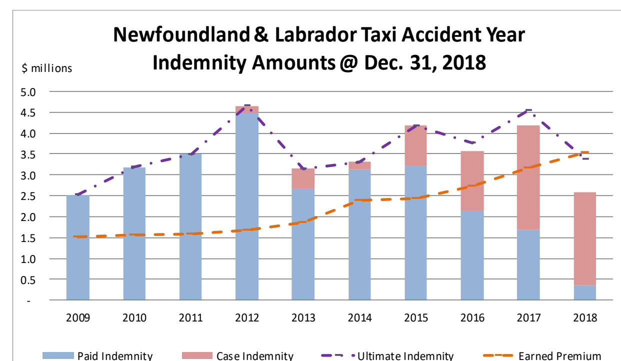
Shawn Doherty, FCAS, FCIA
SVP Actuarial & CFO

Newfoundland & Labrador Taxi Industry Experience

According to GISA's 2018 AIX data, taxi earned premium in 2018 accounted for 5.6% 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 4.7% for accident years 2014-2018 inclusive. Over that same period, the **recorded indemnity loss ratio** (i.e. **prior to IBNR**) was **146% for taxis**, compared with 57% for all non-private passenger. This was the highest recorded indemnity loss ratio of any non-private passenger rating class for 2014-2018 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 2009-2018 inclusive) as at December 31, 2018, the FARM taxi ultimate indemnity loss ratios have ranged from a low of 95% to a high of 278%, with an average of 172% (weighted average of 161%), standard deviation of 51%, and a coefficient of variation of 30%. These statistics highlight not only the high average ultimate loss ratio over the period (172%) but also the high level of relative variation (a 30% coefficient of variation). These results are summarized in the charts below.





At a target indemnity loss ratio of 66% over the period[1], the results suggest rates have been deficient by 172%, 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.

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*

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

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.

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. Behaviour changes can benefit 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.

OW Report Ket Assumptions Discussion

The November 26, 2019 Oliver Wyman ("OW") Report for Facility Association's September 2019 Category 2 taxi rate application (the "OW Report") discussed 15 findings related to the rate level changes (listed in bullet form on pages 4 through 6). Of the 15, 4 (the selected ultimate loss amount, the selected loss cost trend rates, the complement of credibility base, and finance fee revenue) are discussed in detail in the Report, 3 of which we would view as the primary issues (see below).

FA's proposed overall rate level change is +3.9%. Using alternative assumptions, OW has estimated rate indications range from -2.1% to +0.3% (see OW Report page 20 Table 5).

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 3 main categories as outlined below:

1. Projection of Claims Costs - Estimated trends
2. Complement of Credibility
3. Projection of Expenses - Offset for Premium Financing Fees

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

Key Issue 1. *Projection of Claims Costs – Estimated Trends*

FA Discussion of Key Issue 1.

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, UA, and collision; and higher for bodily injury, property damage and comprehensive.*"

There are several key aspects we wish to emphasize.

First, we do not select individual trend rates (or any other individual coefficient value). We selected models that estimated coefficients, based on the design matrix of the models themselves (i.e. the selected explanatory variables). We use a log-linear model form, and assume 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, 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 consider claims frequency correlations across coverages affected by traffic accidents. As well, 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.

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 2018-H1 benchmark trends for the FA trends decreases 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. *Complement of Credibility*

FA Discussion of Key Issue 2.

The OW Report states on page 13: "*As stated in the two recent prior Board's Decision A.I.4 (2017) and A.I.3 (2019) 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. We understand the Board's position would be the same as its prior Decision. In the prior filing, the Board approved the use of the net trend rate as the basis for the complement of credibility.*"

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 below, 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.

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	base on-level Premium	Premium Shortfall*
Jan-13	as filed	66.4%	48.0%	48.6%	47.9%	12.5%	0.1%	0.5%	1,587,985	1,588
Mar-14	as filed	78.1%	53.9%	21.6%	19.3%	49.3%	29.0%	1.9%	2,484,917	720,626
	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%	-	3,173,644	1,113,949
	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%)	3,721,600	52,102
	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%)	4,652,187	437,306
	excess of prior residual	9.5%	27.9%	18.3%	18.6%					
Jul-18	as filed	26.3%	10.2%	4.6%	3.7%	21.8%	6.3%	0.9%	4,044,724	254,818
	excess of prior residual	(4.3%)	0.7%	5.0%	3.7%					
Sep-19	as filed	20.3%	3.9%	0.3%	-	20.3%	3.9%	0.3%	3,784,000	147,576
	excess of prior residual	(1.2%)	(2.3%)	(0.6%)	-					

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.

The FA assumptions over time have led to the current state as being in steady state in our view. Per our filings Exhibit C-1, the 2 LRs are:

- 75.2% (complement LR)
- 76.5% (experience LR)

In contrast, while the gap between the experience LR and the NL PUB complement LR has narrowed overtime (as we expected it would – we provided a projected path to this end back in 2015 that has largely been followed), the NL PUB's complement at 71.3% is still a significant 5 points below the experience. Should the NL PUB continue to rely on their selected complements rather than making a one-time switch to the FA assumption, it will take another two more rate filings before the complement LR differences between FA and the NL PUB closes on its own (the NL PUB will move toward the FA due to the FARM experiencing pulling it up).

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

FA Discussion of Key Issue 4.

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 30 to 31) of the Actuarial Support section of our filing submission.

Premium finance 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), and the investment income opportunity costs of the funds (the investment income that could have been earned on the funds had they not been used in providing a loan on behalf of the policyholder).

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. Assuming 12-month 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%).

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. administrative costs associated with managing the premium financing function need to be included;

ii. an estimate of the bad debt costs (i.e. credit losses) needs to be included (that is, an estimate of the long-term average credit loss – i.e. premium related to a policy period exposure or time-on-risk that is ultimately not collected – so that coverage is provided during that time-on-risk period but no premium was collected from the policyholder);

iii. 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, creating an investment income opportunity cost); and

iv. supporting capital and the after-tax return on that capital needs to be included (i.e. provision for a return on capital for providing the service).

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.