July 16, 2021

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

Attention: Cheryl Blundon, Director of Corporate Services and Board Secretary

RE: Public Utilities Board Requests for Information, PUB-FA-001 to PUB-FA-011, Issued: June 25, 2021 - Response

Dear Ms. Blundon,

Facility Association (FA) received a copy of the June 25, 2021 Public Utilities Board Request for Information. FA appreciates the opportunity to provide comments, as presented on the pages that follow, and is happy to provide any additional clarification as needed with respect to our comments.

FA's role in the market place is to guarantee the availability of automobile insurance to those eligible to obtain it, with the Facility Association Residual Market (FARM) acting as the "market of last resort". A healthy and competitive voluntary market keeps the FARM's size relatively small.

For 2019, the FARM's market share in Newfoundland & Labrador was 3.6% and is estimated to increase to 3.8% in 2020. The FARM private passenger premium level in 2020 was the 5th largest of 12 active insurer groups (including the FARM) in the province, according to MSA data.

Considering that FARM results are shared with the voluntary market, it is important, in our view, that the FARM's rates are set to generate an appropriate return to ensure a properly functioning market, and to provide an appropriate signal to drivers of the risk profile they present, which is largely a factor of their driving behaviors.

Sincerely,

Fadia Charbine

VP Underwriting, Claims and Operations

PUB-FA-001: *Explain why it is appropriate for Facility Association ("FA") to include a profit provision in its rates given that it is an unincorporated non-profit association.*

Response:

With the upcoming implementation of IFRS 17, a thorough legal review of Facility Association has been done to understand the treatment of FA residual mechanisms within the automobile insurance ecosystem. The review confirmed that FARM business is collectively written by FA members i.e. members are the counterparty to the insurance contract written via the Servicing Carriers. FA is the "conduit" which facilitates the sharing of the risk.

FA is an unincorporated non-profit association; the results of the insurance written through Servicing Carriers, on behalf of members, is shared within the insurance industry. This means that profits shall be credited or distributed to each member and losses shall be charged against or collected from each member in accordance with the member's appropriate participation ratio as determined in accordance with the Plan of Operation. As such, all the member insurers share FA's profits or losses.

In summation, while FA is a non-profit association, FA members whose capital supports the business written through FA are writing business for a profit. In fact, in NL, they are allowed/subject to a 5-6% RoP benchmark i.e. *"…the Board will generally accept as reasonable in rate filings is 5%-6%"*. Consequently, FARM business should also be allowed a profit provision as it is collectively written and supported by FA members.

PUB-FA-002 *Explain why FA does not currently include a profit/cost of capital provision in any of its Newfoundland and Labrador ("NL") rates.*

Response:

Prior to the 2020 reform, the NL PUB filing guidelines specifically stated that the profit margin guidelines did not apply to FA (see the 2011 filing guidelines excerpt below):

Profit Margin Guidelines (Excluding FA)

- The Board accepts the following as reasonable for use in rate filings:
    - target after-tax return on equity of 10.0%;
    - premium to surplus ratio of 2.0:1; and
    - return on investment in the range of 2.8%-4.0%.

In 2007, FA submitted a filing that requested a profit provision but the filing was withdrawn at the time therefore it was not presented to the Board for consideration.

Following the reforms and mandatory filing requirements introduced in 2020, the explicit restriction excluding FA from including a profit provision was removed from the filing guidelines. A recent review of the applicable legislation also demonstrated that nothing was precluding FA from requesting to include a profit provision in its rate indications.

As per our answer to PUB-FA-001, we believe FA's rates should include a profit provision and since the current legislative/regulatory environment doesn't preclude it, FA is requesting the profit provision be included in the FA's rates.

PUB-FA-003 *Explain what currently happens to any profits or losses incurred by FA in NL. In the response, confirm if this will change if a profit provision is approved by the Board.*

Response:

Based on the FA's Plan of Operation ARTICLE V – PARTICIPATION RATIOS AND SHARING,

> *[…] At the end of each fiscal year, profit or loss for each class of business shall be determined separately for each accident year in each jurisdiction in accordance with accounting procedures approved by the Board. Calculations for an accident year shall include all policies earned during such calendar year. <u>Profit shall be credited or distributed to each member and loss shall be charged against or collected from each member in accordance with the member's appropriate participation ratio determined in the manner hereinafter set forth in this Article V</u>.* (Emphasis added)

If a profit provision is approved, there will be no change to Article V. This will only affect the level of profits or losses incurred by FA in NL.

PUB-FA-004 *Explain the capital requirements with respect to supporting FA business. In the response, please confirm who sets the capital requirements and who holds the capital.*

Response:

As per Note 17 (Management of Capital) of the financial statements of the Facility Association Residual Market Segment (FARM) and Uninsured Automobile Funds (UAFs):

"The FARM and UAFs are not required to maintain their own capital. The FARM and UAFs allocate their transactions and balances to members, and those members are responsible for maintaining appropriate capital to support those transactions and balances in accordance with applicable insurance regulatory requirements."

PUB-FA-005 *How does FA know that insurers are not already charging in their regular market rates for the capital held and notionally assigned to the FA book?*

Response:

As per discussion with our Members, it is general practice in the industry that the rates charged are determined based on insurers' loss experience (except for credibility complement), expenses and pricing assumptions.

It is important to keep in mind that, in Newfoundland specifically, companies are permitted a profit provision on premium, not on capital, and thus the regulatory structure precludes companies charging for the FA capital they are holding.

This being said, once we receive approval from the Board, FA will send a survey to the CEO's of all member companies writing insurance in Newfoundland and Labrador for each class of vehicle indicating whether or not the current rates of each such company reflect, either implicitly or explicitly, the Cost of Capital to support its FARM business. FA did a similar survey when the cost of capital provision for FARM rates was approved in Nova Scotia. Please refer to Appendix A: Bulletin F10-035 (Cost of Capital Provision – NS Survey) May 26 2010.

PUB-FA-006: *Explain any underlying consequences that exist for member companies and/or policyholders where voluntary market rates include a profit provision and residual market rates do not.*

Response:

If voluntary market rates include a profit provision and residual market rates do not, then the FARM rates might be lower than the voluntary market rates. All other things being equal, the same risk would automatically find a cheaper price under FARM because of the lack of profit provision.

Insurers choose to do business in a jurisdiction because they can make a fair return on their capital. FA strives to be as small as possible to ensure that the FARM remains a marginal player in the market, and consumers are served by a healthy, competitive market. That is best achieved by a FARM that is self supporting, and not a drain on member's capital, and thus fulfills the role of market availability at the point of rates that cover the costs, including claims, expenses and capital which make that market possible. A systemic shortfall in any of those three areas will have long-term consequences for the health of the entire insurance market in the province.

We believe that the fact that FARM rates do not include a profit provision results in a systemic shortfall and may contribute to insurance availability issues in NL. You will find evidence of this systemic shortfall in our answer to PUB-FA-009 and PUB-FA-010

PUB-FA-007 *FA notes that its Board of Directors has set a target post-tax ROE of 12% in general for FA Residual Market ("FARM") rates.*

a) How was FA's internal 12% ROE target determined?

b) Why did FA use the Board's profit guideline of 6% of premium as the basis for its proposed rate change instead of its own internal target of 12% ROE?

c) Why is FA's proposed overall rate level change of +8.9% less than the indicated need of +10.7% using the Board's profit guideline?

Response:

a) The industry long-term average ROE and considerations for the business reality of FARM business (e.g. low retention, rapid changes in business mix, the coverage weights being tilted toward risky coverages such as Bodily Injury and Accident Benefits) were the basis of the selected 12% ROE. As shown in the table below, this internal target of 12% ROE is close to what FA is allowed to use in other jurisdictions except for a certain extent in Ontario.

The table provides the profit provision allowed for FARM PPV business across all jurisdictions as well as the equivalent RoP for the target 12% after-tax ROE. Please note that the conversion from ROE to RoP takes into consideration the 1.44% return on investment as well as applicable tax rate.

Regulatory Benchmark

Jurisdiction	ON	AB	NL	NB	NS	PE	YT	NT	NU
Metric	RoP	RoP	RoP	ROE	ROE	ROE	RoP	RoP	RoP
current benchmark	5.0%	7.0%	0.0%	12.0%	11.0%	12.0%	7.0%	7.0%	7.0%
current benchmark as RoP	5.0%	7.0%	0.0%	7.7%	7.1%	8.0%	7.0%	7.0%	7.0%
Average RoP	6.2%								
Average RoP excl. NL	7.0%								
Average RoP for NB, NS and PE	7.6%								
Corresponding RoP for 12% ROE	7.5%	7.2%	7.9%	7.7%	7.7%	8.0%	7.5%	7.5%	7.5%
Average RoP	7.6%								
Average RoP excl. NL	7.6%								
Average RoP for NB, NS and PE	7.8%								

b) If there is a benchmark specified for a profit provision, it is our usual practice to set our assumption as per the benchmark. As shown in the table above, the 12% ROE would translate into a 7.9% RoP in NL and an average of 7.6% for the other jurisdictions. In addition, the current allowed profit provision in other jurisdictions translates into an average of 7.0% RoP. Based on this, we decided to request the Board's profit guideline of 6% of premium.

c) To minimize the impact of the introduction of a profit provision in NL, we decided to propose no change to the physical damage coverages and to cap Third Party Liability to a 12% rate change. Again, the proposed changes are based on a 6% RoP profit provision.

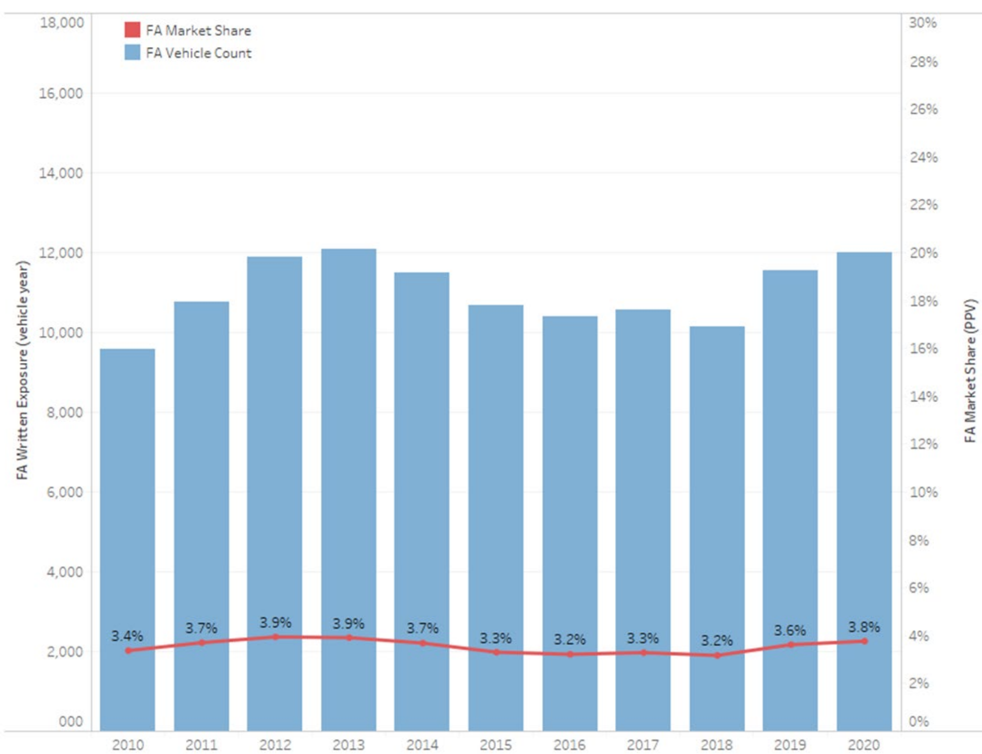
PUB-FA-008 *FA notes that 21% of FARM placements in 2020 were due to "Premium Lower than Other Markets" and suggests that the integration of a profit provision would assist in delivering on FA's purpose to minimize market presence and provide consumers with the benefits of a competitive standard insurance market.*

Provide the FA Private Passenger Vehicles ("PPV") market share in NL for each of the last ten years.

a) *Provide a comparison of FA's current PPV market share for all jurisdictions in which FA operates.*
b) *If a risk is placed/renewed in FA due to "Premium Lower than Other Markets", does this mean that FA has the lowest premium in the industry for that risk, or just lower than the select carriers used by the agent/broker who places the business?*
c) *Provide any evidence that FA has to confirm that adding a profit provision to its rates will reduce the number of FA placements due to "Premium Lower than Other Markets."*
d) *Aside from integration of a profit provision, has FA explored any other potential options to help minimize the residual market size? If so, please explain.*

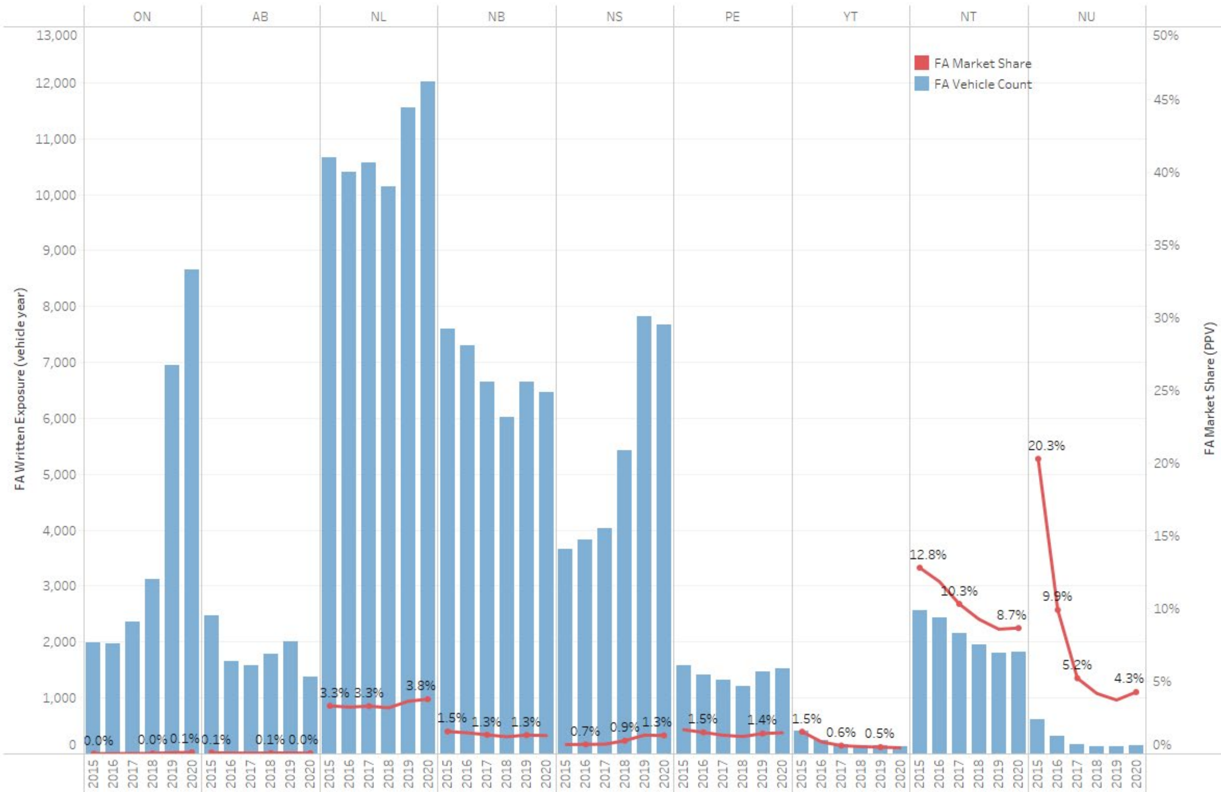
Response:

Please find below details of the Newfoundland and Labrador FARM Private Passenger Market Share for the last ten years (2010 through 2020):

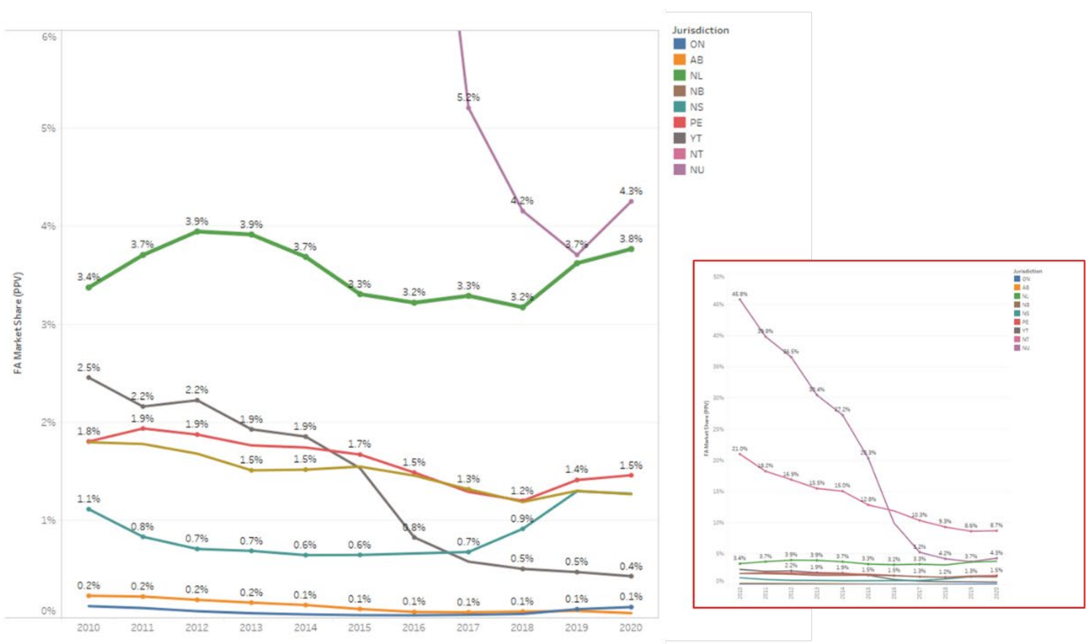


Data source: FARM data comes from 2010 to 2020 FA segmentation data; Industry data comes from 2010 to 2019 industry segmentation data. (2019 industry data was used as an estimate for 2020 since the 2020 data is not yet available)

a) The charts below provide details on FA's current PPV vehicle count and market share for All Jurisdictions (2015-2020):



Data source: FARM data comes from 2015 to 2020 FA segmentation data; Industry data comes from 2015 to 2019 industry segmentation data. (2019 industry data was used as an estimate for 2020 since the 2020 data is not yet available)



Note: We have limited the chart's axis to highlight NL market share , **the uncapped chart is inset**

b) When a risk is reported as placed or renewed with FA due to "Premium Lower than Other Markets", this indicates that the FA premium was the lowest premium available from the select carrier(s) used by the Agent/Broker to place the business.

c) Throughout 2020, Agents/Brokers selected "Premium Lower than Other Markets" as a primary reason on approximately 2,500 new business and renewal policies (with other market premium breakdown). The comparative premium information completed by the Agent/Broker indicated that the FA premium was on average $631.48 lower than the next available standard market carrier. The summary chart below outlines the average premium difference indicated by Agent/Broker Offices in 2020:

Brokerage	Average of Difference	
Broker A	$	(610.11)
Broker B	$	(804.71)
Broker C	$	(733.73)
Broker D	$	(562.10)
Broker E	$	(1,090.35)
Broker F	$	(684.19)
Broker G	$	(261.86)
Broker H	$	-
Broker I	$	(566.91)
Broker J	$	(420.31)
Broker K	$	(690.14)
Broker L	$	(701.25)
Broker H	$	(660.03)
Average - All Offices	**$**	**(631.48)**

d) Facility Association has frequently filed for increases to base rates, based on experience. The chart below summarizes the rate filing activity from 2018 to 2020:

Year	Jurisdiction	Business Class	Annualized Vehicle Count	Proposed Rate Change	Date Filed with Regulator	Date of Regulators Decision	Regulatory Decision	Rate Approved	Additional Notes and/or Comments
2018	Newfoundland	PPV	10,407	15.7%	10-Nov-17	4-Oct-18	Approved	6.5%	Refile of +6.5% sent July 20, 2018
2019	Newfoundland	PPV	10,040	7.30%	13-Sep-19	19-Dec-19	Approved	4.00%	Original filing denied. Refiling +4.0% on Dec 12/19
2019	Newfoundland	PPV	10,040	0.00%	31-Oct-19	4-Nov-19	Approved	0.00%	Winter Tire Discount applied
2020	Newfoundland	PPV	11470	-1.40%	23-Jun-20	2-Jul-20	Approved	-1.40%	NL Reform Filing

In addition to reviewing private passenger rate indication on an annual basis, Facility Association frequently reviews the mix of business in our FARM Book, and requests Servicing Carriers to engage Agents/Brokers to evaluate the risk, in an effort of securing placement in the standard market.

Our last depopulation exercise reviewed FARM PPV business that was effective between April 2020 and March 2021, and focused on vehicles that met the following conditions:

1. Were rated at a Driving Record 5
2. Were active in the FARM for a minimum of 5 years
3. No at-fault losses reported within the last 5 years
4. No convictions were reported within the last 3 years

In Newfoundland & Labrador, 643 policies met the above noted criteria, with a renewal term effective date between April 2020 and March 2021. The 643 policies reviewed in Newfoundland represented 46.7% of the total FARM policies reviewed.

Jurisdiction	Number of Policies Reviewed
Alberta	5
New Brunswick	244
Newfoundland & Labrador	643
Nova Scotia	165
Northwest Territories	192
Nunavut	10
Ontario	61
Prince Edward Island	48
Yukon	6
Total	**1374**

Facility Association provided a policy list to our Servicing Carriers and obtained quarterly updates as to the number of policies that were successfully remarketed, or cancelled. To ensure accuracy details were verified using FARM Automobile Statistical Plan data.

Out of the 643 policies that met our search criteria (Driving Record 5, no chargeable at-fault accidents or convictions), 458 policies or 71.2% renewed with the FARM.

PUB-FA-009 *Provide the historical profit/loss amounts distributed to members for FA PPV business in NL for each of the last ten years.*

PUB-FA-010 *Provide the historical profit/loss amounts distributed to members for all FA business in NL (i.e., all vehicle classes combined) for each of the last ten years.*

Response:

The table below shows historical profit/loss amounts distributed to members for FA PPV, Non-PPV and Total business in NL for each of the last ten years.

Please note that FA's sharing is done on an accident year and therefore, the Operating Results shown in the table are on an accident year basis and life-to-date as of April 2021.

	Operating Results										
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total
PPV	-770,699	-298,198	-432,082	-995,670	-3,335,176	-4,354,996	1,036,385	-2,872,522	-2,769,281	1,915,324	-12,876,915
Non-PPV	-2,244,047	-3,201,612	32,160	-310,513	-3,851,740	-1,583,454	-933,550	-380,326	-204,814	988,758	-11,689,138
Total	-3,012,735	-3,497,798	-397,909	-1,304,169	-7,184,901	-5,936,434	104,852	-3,250,830	-2,972,076	2,906,102	-24,545,898

It is important to note that the actual overall results would be worse if we were to adjust them for costs directly assumed/paid by FA's members to support the FARM business. These net costs are mainly for direct costs such as Premium Taxes, Health Levies and deemed Cost of Capital (as per MCT Guidelines) netted by the investment income earned on funds held by members i.e. capital supporting FARM business as well as the assets supporting its insurance cash flows.

PUB-FA-011 *Please confirm if FA intends to propose a profit provision for its other classes of automobile insurance in NL.*

Response:

As shown in the table above, the Non-PPV segment has been clearly unprofitable for the last 10 years and therefore, it is our intention to request a profit provision for all classes of automobile insurance in NL.