July 8, 2021

Oliver Wyman

120 Bremner Boulevard, Suite 800,

Toronto, Ontario

M5J 0A8

Attention: Paula Elliott

RE: FA NL **Private Passenger Vehicle Automobile Rate Application – Category 2** – Response to email June 29, 2021

Dear Ms. Elliott,

Facility Association (FA) received questions in regard to FA Newfoundland and Labrador Private Passenger Vehicles Rate Filing in 2021. Our responses to the questions are provided on the pages that follow.

Best regards

Liqing Yang, FCIA, FCAS

Pricing Actuary

Profit Provision

OW Question 1 (consists of 2 questions) *In prior IR#1, Q8, FA was asked to estimate the ROI considering all investment assets held by insurers. In the response, FA explains the "transfer of funds" and accounting of those transfers as a different environment that FA operates under. However, FA does not address the return on investment rate that the capital supporting such business might be achieving when invested in equities (e.g., stocks) held by insurers.*

i. Explain why reference to equity investments was excluded by FA in its response.

FA Response to OW Question 1.i

Considering the uniqueness of FARM funds (i.e. on-demand callability and fund segregation), we believe it is reasonable to assume that the funds held by FA's member companies backing FARM business would be invested in highly liquid low risk assets. Therefore, equity investments would not be considered in the ROI used in pricing FARM business.

Indeed, as stated in our June 7, 2021 response to IR#1 question 8, the callability and segregated nature of FARM funds are well defined in the following excerpts of **FA Bulletin F05-031** (TRANSFER OF FACILITY ASSOCIATION RESIDUAL MARKET (FARM) RELATED FUNDS TO MEMBER COMPANIES):

1. ***Purpose of Transfer of Funds***
   a. *… **FARM policyholder funds held by Members will eventually need to be returned to the Facility Association to enable it to pay the policyholder claims to which these funds relate.***

2. ***Timing of Repayment to the Facility Association***
   a. *While the Facility Association will make every effort to provide a full quarter advance notice before requesting the return of any of these funds from Members, this may not always be possible **since cash flows can be quite volatile within the residual markets. All members must remain prepared to return funds within the timeframe requested by the Facility Association**, since all requests will be solely as a result of an impending need to pay claims and/or return unearned premiums to policyholders insured through the FARM.*

3. ***Accounting for this Transfer of Funds***
   a. *Be sure to **maintain the balance "FARM Funds due to Facility Association" separately in your books** since there should be no interaction whatsoever with any other Facility Association account maintained within the books of your company. Facility Association will administer both the payment of these funds to your company and the eventual recollection of same from your company, i.e. to allow*

Facility Association to pay the FARM policyholder claims to which these funds relate.

Finally, considering OSFI MCT guideline regarding Equity risk i.e.

"Equity risk is the risk of economic loss due to fluctuations in the value of common shares and other equity securities.

A 30% risk factor applies to investments in common shares and joint ventures in which a company holds less than or equal to 10% ownership interest."

Our current pricing indication is based on an environment where the supporting funds (capital) are only invested in bonds. Inclusion of equity investments would require increased capital to support the increased risk factor, resulting in a decrease in the investment return. Indeed, all assumptions need to be considered holistically and not on a stand-alone basis, including consideration of equity investments should also include consideration of an increase in the required capital (leverage ratio).

OW Question 1 (continued)

ii. *Does FA have evidence that the investment assets associated with the capital held by insurers for FA business does not include equities?*

FA Response to OW Question 1.ii

As per bulletin F05-031, transferring the funds to Members will allow them to invest funds related to FARM business based upon their own investment plans and policies. As such, FA is not monitoring/auditing how members are investing funds related to either their FA business or (obviously) their regular business.

Considering the level of expertise in our members' investment teams, we believe that the nature of FARM funds, particularly with respect to the on-demand callability of the funds, as mentioned in our answer to Question 1.i, are taken into considerations when invested.

OW Question 2 *Regular/voluntary market insurers receive premiums from policyholders and invest those funds until they are needed to pay the claims. In the course of doing so, regular/voluntary market insurers must be prepared to pay claims as the settlement process unfolds. For the FA portfolio, insurers receive (their proportionate share of the) premium funds from FA (rather than from the policyholder) and must pay (their proportionate share of) claims (by sending funds to FA) as the need arises according to when payments must be made on the FA claims that occur.*

Other than separate accounting, explain how the funds received/distributed by insurers for regular/voluntary (i.e., non-FA) business is different than for their FA business – with respect to the ability to invest those cash flow related funds – as compared to their regular/voluntary market business.

FA Response to OW Question 2

Please refer to the response to OW Question 1.

OW Question 3 *Insurers are expected to hold sufficient capital to support their share of the FA business that they assume. And this capital is not provided by FA, but instead by each individual insurer. The associated capital for FA business held by insurers is notionally earmarked for the FA business; and invested in any manner that the insurer chooses – subject to OSFI regulations – as with its own direct business capital.*

In this rate application, FA requests an after-tax return on this capital (held by insurers) using a 6% of premium approach.

Given this, would there be any reason (e.g., FA Plan of Operation Articles) that would prevent the investment rate on the capital assets held by insurers for the FA business to be any different than the rate on the capital associated assets held for non-FA business?

FA Response to OW Question 3

Please refer to the response to OW Question 1.

There is no reason that would prevent the investment rate on the capital assets held by insurers for the FA business to be any different than the rate on the capital associated assets held for non-FA business.

However, as per bulletin F05-31:

> *"…since cash flows can be **quite volatile** within the residual markets. All members must remain prepared to return funds within the timeframe **requested by the Facility Association**",*

the members should hold liquidity and low risk investments to make sure the funds would be available to fulfil this requirement. As stated previously, we are confident that our members' investment teams consider this.