

In the matter of a public hearing of an application for the inclusion of Cost of Capital in the Facility Association rate applications for Private Passenger Vehicles, Commercial Vehicles and Miscellaneous Vehicles.

Decision

The New Brunswick Insurance Board (The Board) convened a **Public Hearing** on September 1, 2009 to consider the application by the Facility Association (FA) to include a Cost of Capital in their rate applications for Private Passenger Vehicles, Commercial Vehicles and Miscellaneous Vehicles.

Pursuant to subsection 19.71 (1) a Notice of hearing was published. Pursuant to subsection 19.71 (2) the Board notified the Superintendent of Insurance, the Attorney General of the Province and the Consumer Advocate for Insurance of the hearing on July 16th, 2009.

Attached herewith are a copy of the Notice and a list of all Parties.

The evidence consisted of written submissions from:

FA, presented by Mr. Dave Simpson, President of FA;

Independent Brokers Association of New Brunswick, Mr. Georges Leger, President;

Pembridge and PAFCO Insurance Co., by J.R. (Bob) Tisdale, President & Chief Operating Officer;

and the oral presentation of the Consumer Advocate for Insurance for New Brunswick, Mr. Ronald Godin.

It must be noted that a panel of the Board was asked to consider a similar issue as part of a Public Hearing held on June 27, 2005. The panel decided against allowing a Cost of Capital on the affairs of FA. The Board determined that FA had not provided sufficient evidence to justify inclusion of a Cost of Capital in their rate making.

The Board's decision to re-consider FA's request is based on new evidence and the fact that the Board has established new processes that ensure ratepayers of a rigorous rate review process. The implementation of new territories by the Provincial Government also ensures that rates are developed in a risk base environment, eliminating cross subsidies, therefore the Board has allowed FA to represent its case.

Facility Association presented the Board with a submission that contained three major themes.

1. The Cost of Capital is a real cost and because rates should be developed to cover expected costs, that cost should be included in the rates.
2. If voluntary market rates include a Cost of Capital provision and F.A. rates do not, there is an implicit subsidy of F.A. rates.
3. Allowing that implicit subsidy can result in F.A. rates being inappropriately competitive with those of its member companies. When that happens, companies specializing in non standard risk cars and drivers can be squeezed out of the market by F.A., reducing the range of choice of providers available to consumers.

A. Facility Association submission

1. The Cost of Capital is a Real Cost

The Board accepts and understands that Cost of Capital is a real cost based on the additional evidence provided by FA in their submission. From the evidence, the Board agrees that FA is a not for profit organization when it comes to its administrative activities towards its member companies. The Board also recognizes that the positive or negative balances of the New Brunswick residual insurance pool, belongs to the members. Furthermore the Board also understands that the premiums and losses must be supported by capital at each company as required by the Office of the Superintendent of Financial Institutions (OSFI). The Board also understands that companies are responsible up to the percentage of their individual market share in the province i.e. a company that has 10% of the market share in New Brunswick would have a 10% stake in the residual market insurance pool.

2. Voluntary Market Include Cost of Capital (ROE) and FA Rates do not Represents an Implicit Subsidy of FA Rates

The Board had a substantial discussion on this very matter. The Board is of the opinion that all sectors of the automobile insurance market should be treated equally, be it the regular market, the sub-standard market or the residual market. The Board has established strict filing guidelines where companies have to use the same methodology and supply the same type of data to the Board in order for the Board to make their decision. The Board, with the expertise of its consulting actuary, has also defined all of the acceptable actuarial principals to be used by companies offering automobile insurance in New Brunswick. Cost of Capital or (ROE) is one of them. Therefore, the Board agrees there is an implicit subsidy by not allowing FA to include Cost of Capital in their rate filing.

3. Allowing that implicit subsidy can result in FA rates being inappropriately competitive with its member companies.

By not allowing all of the market to charge for a Cost of Capital, the Board could inadvertently be keeping the costs of FA lower than the market. This would translate into

lower rates that would be competitive with the non-standard market. The recent soft insurance market has made it difficult for the Board to assess this. In a soft market companies have a tendency to relax their underwriting rules. Non-Standard companies did indicate to the Board that “if this market did not exist at prices less than the FA, or if this market was forced to compete with FA, the size of FA could grow to the point where it becomes a major player in the market resulting in an affordability crisis.” The Board also understands that there are some risks that will never be underwritten by any insurer but FA. Examples of this are drivers convicted of driving while impaired, drivers with multiple convictions and drivers with multiple at-fault losses. In the last few filings the Board has approved rates for FA that were less than the indicated rate reduction, so as they would not be competing with their members. The Board has no intention of continuing in that manner. In a risk based environment the Board has to evaluate each filing on sound actuarial principals regardless of what market companies operate in. If there were no competitive sub-standard market, ratepayers would be placed in FA at a much higher rate than would exist in a competitive sub-standard market. FA should really be the insurer of last resort. No risk should end up in FA simply because FA is more price competitive than the regular or substandard market.

B. Oral submission by the Consumer Advocate for Insurance

Presentation by Ronald Godin

1. Concerns of overlapping /double dipping

In his presentation, the Consumer Advocate indicated that the allowance of Cost of Capital to FA could potentially bring companies to overlap or for lack of a better word double dip which could result in companies being overcompensated for the capital set aside for the FA portion of the company. The Board has the means at its disposal to ensure rate payers that this would not happen. The Board would not allow overlapping.

2. Allocation of premium

The Consumer Advocate questioned the allocation of premium stating “What it is going to mean in fact, is that the 6,000 clients in your market are going to be hit by the tune of a hundred to two hundred dollars, and the regular market insured’s are going to probably benefit very, very marginally.” The Board is of the opinion that each individual risk should be assigned to the proper market. Each market should be properly priced. By allowing the residual market to be priced properly, this creates an opportunity for the sub-standard market to remain competitive and grow as opposed to having FA. grow. A risk in the sub-standard market will generally have a premium much lower than FA.

3. Subsidization

The Consumer Advocate touched on socially acceptable subsidization where it would be socially acceptable for the regular market to subsidize the FA market. The Board is not

involved in public policy making. The role of the Board is to regulate policy made by government and the Board will not take it upon itself to determine what should or should not be subsidized. The Board's legislative mandate is to ensure that rates being charged by insurance companies are just and reasonable.

Conclusion

The New Brunswick Insurance Board, following deliberations and examination of the evidence submitted, reached a unanimous decision allowing Facility Association to use a Cost of Capital in their future rate filings with the Board. The Board further orders that all insurance companies writing automobile insurance in New Brunswick must include in any filing a statement signed by the CEO that no cost for their portion of capital set aside for the FA insurance pool in New Brunswick is part of their individual annual filling.

Dated in Saint John New Brunswick this 22nd day of September 2009

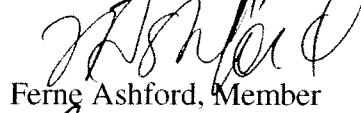
By Order of the Board



Paul D'Astous, Chairman



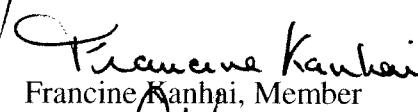
Vincent Duff, Vice-Chairman



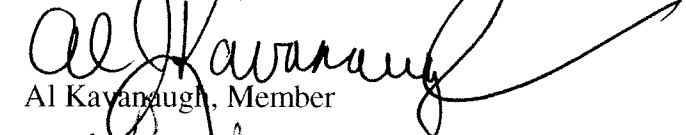
Ferne Ashford, Member



Armand Brun, Member



Francine Kanhai, Member



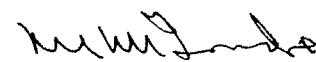
Al Kavanaugh, Member



Yvon Landry, Member



Jean-Guy Richard, Member



Matthew Tweedie, Member

New Brunswick Insurance Board

NOTICE OF HEARING

The New Brunswick Insurance Board (the Board) has received a request from Facility Association to consider the inclusion of a cost of capital provision in Facility Association automobile insurance rates.

The Board hereby orders that a public hearing be held to consider this request.

The hearings will commence September 1, 2009 at 9:30 am in the Delta Hotel Trinity Royal Room, in the City of Saint John, New Brunswick. If necessary the hearing will continue on September 2, 2009, until such time as all matters have been addressed.

Pursuant to subsection 19.71(2) of the *Insurance Act*, specific notice is being provided to the Attorney General, the Superintendent of Insurance and the Consumer Advocate for Insurance in electronic and written format.

Pursuant to subsection 19.71(4) of the *Insurance Act*, the Attorney General may intervene at the hearing and make representations that he considers to be in the public interest.

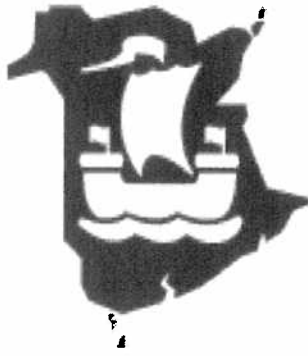
Other interested persons or parties who may wish to be considered for intervener standing should make an application to the Board, in writing, no later than August 6, 2009. The application must include the name of the person or party, their mailing address, civic address, telephone and facsimile numbers and e-mail address (if applicable). They must also establish their interest in the hearing that would justify their possible intervener standing. Decisions of the Board in the granting of intervener standing are final. Applications should be submitted by mail and electronically to info@nbib-canb.org

DATED at the City of Saint John, New Brunswick this 16th day of July, 2009.

C. Kevin Duff
Secretary to the Board

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New Brunswick Insurance Board

Parties

IN THE MATTER OF a **Public Hearing** to hear:

Facility Association's Cost of Capital

PARTIES:

REPRESENTED BY:

FACILITY ASSOCIATION -----

Mr. David Simpson
President

Ms. Jill Hepburn
VP Underwriting

CONSUMER ADVOCATE FOR INSURANCE-----

Mr. Ronald Godin
Consumer Advocate

NEW BRUNSWICK INSURANCE BOARD -----

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Mr. Armand Brun
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Mr. Jean-Guy Richard
Ms. Francine Kanhai
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Mr. Matthew Tweedie

Consultants: Mr. Richard Gauthier

Staff: Mr. Kevin Duff
Secretary to the Board

Ms. Kelly Ferris
Manager of Insurance Services