SUBMISSION BY

THE CONSUMERS' ASSOCIATION OF CANADA, SASKATCHEWAN BRANCH

TO

THE SASKATCHEWAN RATE REVIEW PANEL

IN THE MATTER OF

THE APPLICATION BY SGI/AUTO FUND TO ADJUST ITS PREMIUM RATES IN 2007

March 14, 2007

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The Consumers' Association of Canada, Saskatchewan Branch, welcomes the opportunity to appear before the Saskatchewan Rate Review Panel and speak to the 2007 application by SGI/Auto Fund for a rate adjustment.

The application is triggered by the fact that the Auto Fund is "collecting more premium than required to pay claim costs and other expenses" and "the Auto Fund is in the strongest financial position in its history after nine consecutive years of surpluses". (Page 1 of the Proposal Document). The Auto Fund is attempting to introduce a measure of fairness to the current rate structure and proposes to rebalance rates because "some customers are paying too much for their vehicle insurance and others are paying too little". (Page 1 of the Proposal Document). The Auto Fund further proposes to limit the rate of rebalancing to avoid "rate shock" among its customers. (Page 1 of the Proposal Document). Rate shock is not defined anywhere in the Document nor is it explained why a rate shock is contrary to the public interest or bad for the vehicle owner.

The Consumers' Association of Canada, Saskatchewan Branch, is in principle not opposed to rate adjustment applications requesting permission to reduce the price(s) paid by some consumers for goods and services. It is a welcome change from the usual rate adjustment requests coming before the Rate Review Panel. Nevertheless, an application for a reduction in rates must be treated with the same rigour and scrutiny as an application for an increase in rates: is the request timely? is it reasonable? is it equitable?

The current application has proven difficult to assess and evaluate in terms of whether the proposed rate reductions are sufficient and the proposed rate balancing changes are equitable. There are three major factors contributing to our assessment problems:

1. <u>Assessing economic performance of the Auto Fund.</u> Automobile insurance services are offered in Canada by both private and government owned firms. In Saskatchewan, the SGI/Auto Fund has been given the authority by the Legislature of Saskatchewan to be the sole provider of basic automobile insurance and as a result operates a provincial monopoly. It has also been authorized to issue vehicle licence plates and drivers' licences in Saskatchewan. The Auto Fund relies on agents throughout the province to sell its insurance policies and to issue vehicle licence plates and drivers' licences.

   How does one assess the performance of a monopoly established to serve the public interest? Is it sufficient to rely on the Auto Fund's declaration cited above that it "is collecting more premium than is required to play claim costs and other expenses" or do we need additional and independent internal and external benchmarks to assess performance? Where do we find them? Can we compare the Auto Fund with private insurance firms or must we limit the comparison to other government owned auto insurance firms in Canada?

2. <u>Assessing equity performance by the Auto Fund.</u> The equity or fairness performance of firms engaged in the insurance industry is inherently difficult to assess because of the nature of the services they provide. Automobile insurance companies offer to provide, for a price (the premium), financial protection against risks and unforeseen events attached to the operations of a specific vehicle by a specific individual. The firms recognize that risky events may reduce or destroy the value of assets (the vehicle) owned by the individual, vehicles and properties owned by other individuals and give rise to financial claims arising from bodily harm, injuries and even death.

   How can and should insurance firms proceed to evaluate the particular risks faced by consumers needing insurance protection and then determine the proper rates to charge their clients? What assurances do we have that clients with similar risks pay similar rates and clients with different risks pay different rates?

3. <u>Lack of relevant information.</u> The Rate Application Document submitted by SGI/Auto Fund does not provide much assistance to interveners wishing to address some of these issues. The paucity of quantitative information with respect to the financial performance of the Auto Fund during the last nine years "of consecutive surpluses" is stark. There is none! The intervener is left to find this information on his own from past annual statements of the SGI and other sources.

   This is also true with respect to the rate balancing issue. Pertinent information is not easily uncovered and it is difficult to assess the relevance of the mass of quantitative information pertaining to vehicle classifications and how it affects rate determination and rate balancing for owners of vehicles in Saskatchewan. One is left to wonder if use of vehicle, location, and driving records are factors used in the process of risk and rate determination.

   Risk determination and rate setting are arcane subject matters for most people; the limited information that is provided guarantees they will continue to remain arcane matters.

<u>Economic Performance of the Auto Fund.</u>

It obvious from the statements contained in the Proposal Document that the SGI/Auto Fund wants to reduce its current revenues which are excessive by its own admission. Lack of relevant information in the Document makes it impossible to determine why the net revenues are excessive, how long they have been excessive and to express an opinion about the sufficiency of the proposed rate adjustments.

We began our search for more information by reviewing the sales information of new motor vehicles in Saskatchewan between 1997 and the end of 2005 as recorded by Statistics Canada, Series 63-007. During those nine years total sales of new vehicles were 349,192 units with an annual average of 38,800 units. The total value of the sales during the same period was approximately $ 11.2 billion.

We have no information about the approximate value of the provincial stock of vehicles as insured by the Auto Fund but we note from the Proposal Document (Page 2) that the Auto Fund was insuring 838,000 vehicles at the time the Document was prepared.

To gain some insight into the operations of the Auto Fund we obtained a copy of the 2005 annual report of the Auto Fund and reviewed it. It was the most recent report listed on the Web site of the Auto Fund. From the audited financial statement included with that report we looked at the Statement of Operations and Rate Stabilization Reserve. (Page 44 of the 2005 Annual Report). It provides a snapshot of the financial operations of the Fund in 2005.

We note that net premiums earned in 2005 were $ 519.9 million, that total claims and expenses were $ 546.4 million and that the Auto Fund experienced an underwriting loss of $ 26.4 million in that year. During 2005 investment earnings of $ 67.7 million and other income of $ 20.1 left the Auto Fund with net earnings of $ 61.4 million which was transferred to the Rate Stabilization Reserve. The Auto Fund had accumulated $ 163 million in the Rate Stabilization Reserve by the end of 2005.

We note that at the end of 2005 the Auto Fund lists among its assets investments of $ 1 billion. We were surprised to learn that the actual rate of return on its portfolio was only 6.9 % in 2005. During the same year the Saskatchewan Pension Plan returned 10.1 % to its members and had achieved an annualized 10 year rate of return of 9.5 %. It is not clear why the investment performance of the Auto Fund should trail the Pension Plan investment performance by 320 basis points.

We wanted to review the economic performance of the Auto Fund between 1997 and 2005 but we were forced to limit our analysis of the Auto Fund to the year 2005 only. We were not able to locate copies of the Auto Fund’s Annual Reports for the other years. We found more information about the Auto Fund useful to us as intervener on the web site of the Manitoba Public Insurance than on the Auto Fund’s web site. Using that source we learned that net premiums earned in 1997 were $ 361 million and that the cumulative total of net premiums earned by the Auto Fund from 1997 to the end of 2005 was $ 4.1 billion.

We were not able to determine the value of total claims and expenses during the same time period and the level of investment earnings and other income earnings. Consequently, we cannot comment on the rate of growth in net earnings from 1997 onwards or the sources of this growth.

The Auto Fund claims to have experienced "nine years of consecutive surpluses". It is clear that the annual net earnings (Increase/Decrease to Rate Stabilization Reserve) of the Auto Fund are sensitive to many different factors.

We believe that the Auto Fund should be asked to provide more and relevant financial information at these hearings. Let it now be required to produce the evidence and show us the numbers and the reasons why and how it managed to establish that record. At the very minimum, copies of the audited financial statements for the last nine years should be made available to us all with such comments as the officials of the Auto Fund may wish to add.

Equity performance by the Auto Fund.

The Proposal Document reviews the Rate Balancing proposal in terms of two categories of vehicles, CLEAR-Rated Vehicles and Conventionally-Rated Vehicles. Our comments and review of the Rate Balancing proposal are limited to the CLEAR-Rated Vehicles. That group of vehicles constitutes 66 per cent of the Saskatchewan vehicle population and represents over 80 per cent of premiums collected. (Page 24 of the Proposal Document).

Careful reading of the Rate Balancing section of the Proposal Document makes it clear that the issue of rate balancing is not limited to one of reduction in rates but also involves an application for selective rate increases involving 42 per cent of the vehicles classified in the CLEAR-Rated Vehicle group of customers of the Auto Fund. Page 24 of the Proposal Document identifies the magnitude of the Rate Balancing issue in the following terms: "**only three per cent of customers** (in the CLEAR-Rated Vehicle group) **are currently paying the appropriate premiums**. (Emphasis added).

The Proposal Document notes that 42 per cent of the vehicles currently registered require rate increases and 55 per cent of the vehicles require rate decreases. Consequently, the extent of cross subsidization of automobile insurance rates in Saskatchewan is currently at 97 per cent. That is the percentage of the Auto Fund customers who are being charged improper rates. It is very strong evidence of almost complete inequity and unfairness exercised by the Auto Fund in its past rate setting.

These numbers make it very difficult to believe that customers of the Auto Fund who face the same risks pay the same premiums and that customers who face different risks pay different rates. The opposite is more likely to be true with a probability of 97 per cent!

How could this possibly have happened? How long has this occurred? In our review of the 2005 Annual Report of the Auto Fund we could find no references to the rate setting problem or suggestions that the auditor or the actuary had drawn this problem to the attention of the management. Are there no regular internal reviews of rate structures and risks attached to automobile insurance in Saskatchewan conducted by the Auto Fund, the only agency permitted by law to offer basic auto insurance in the province?

It appears that the credibility of the Auto Fund is on the line and that we must question whether the consumers of automobile insurance in Saskatchewan can afford to permit the Auto Fund, which allowed the development of "an inflation of inequities and unfairness" to occur, now to correct the problems it allowed to develop in the first instance.

Solutions to the current problems may require recommendations for action by the Rate Review Panel beyond those suggested by the Auto Fund in its Proposal Document.

Summary Assessments and Recommendations.

The Auto Fund is acknowledging it is currently facing two problems. It is earning too much and at the same time it is overcharging some customers and undercharging other customers. It is not clear if the first problem is a function of the second problem. Normally, the first issue is never considered to be a problem. It can, however, become an awkward problem for the Auto Fund if its captive customers believe that the improper rates have contributed to the excess earnings.

Despite our criticisms about the inadequacy of the information presented by the Auto Fund in its Document of Proposal, we want to commend the Auto Fund for publicly acknowledging the problems it is facing with respect to the rate balancing.

We prefer to approach the rate balancing issue in terms of two time periods; (a) past rate inequities and, (b) current and future rate inequities. Within each time period we further distinguish between two groups; (i) customers paying excessive vehicle rates and, (ii) customers not paying sufficient rates.

We also prefer to review the rate balancing in terms of dollars and cents. The Proposal Document reviews the rate balancing in terms of the percentage distribution of excessive or insufficient rate paying vehicle categories. We note the Auto Fund's claim that its proposal for current rate settings will cause 64 per cent of the current CLEAR-Rated vehicles to pay proper rates. That is up from 3 per cent and is an obvious improvement. That leaves, however, 36 per cent still paying inequitable rates of which 4 per cent will continue to pay too much and 32 per cent will continue not to pay enough.

It is surreal to discuss rate adjustments solely in terms of percentages. None of us deposit percentages into our bank accounts, we do not receive our wages in percentages nor do we pay our car insurance premiums in percentages. We know that in 2005 the Auto Fund earned net premiums of $ 519.9 million. We also know that premiums collected from owners of CLEAR-Rated vehicles represent about 80 % of the total premiums collected. This means that in 2005 this group of customers paid approximately $ 415.9 million in premiums to the Auto Fund.

We do not have any sense of the dollar values attached to the excessive premium payments made by the 55 per cent of the customers identified as having paid too much according to the Proposal Document. Nor do we have any sense of the total sums involved for the 42 per cent of the customers who did not pay enough.

We want the Auto Fund to make this information available so we can assess the magnitude of the problems in terms of dollar values. The Auto Fund acknowledges it has not done a rate rebalancing since 2001. We therefore request it to present dollar values on an annual basis since 2001 of its best estimates of the total annual excess payments and total deficiency payments. We also would like to review the normal statistical properties (such as the standard deviation etc.) associated with the frequency distribution published on Page 19 of the Proposal Document. Finally, we request that the Auto Fund make available a frequency distribution showing the number of its customers by the size of the over/under premium payments each made.

Without the information requested above we do not know if we are dealing with a "tempest in a teapot" or a problem involving significant sums of monies and significant distributional inequities among Auto Fund customers who must, by law, purchase their automobile coverage from the Auto Fund.

With this information we can assess the magnitudes of past inequities and offer some suggestions how they can be corrected. How should the excessive earnings be returned to the Auto Fund customers who have paid too much in the past? At the same time, how should one address the issue of the customers who have not paid enough for their insurance in the past? Depending on the sums involved we may favour the establishments of notional customer accounts by the Auto Fund to record the credits or debits to track the sums. The funding of these notional accounts is a problem to be reviewed after the total sums have been established.

We realize it is possible the sums may be sufficiently significant to require restatements of past financial statements by the Auto Fund. That is a decision the auditors of the Auto Fund will have to make. For our part, this possibility can not and should not be used to prevent a full and complete accounting of past rate setting inequities.

For both customer groups one must also address the issue of implementing proper and equitable present and future rates. We are not persuaded by the arguments advanced by the Auto Fund why it should not move immediately to implement proper and correct CLEAR-Rated vehicle rates for all its customers in this group.

We are not prepared to accept the Auto Fund's appeal that the process of correcting the current inequities should be subject to "a rate of improving" fairness. That serves only to perpetuate past and current inequities and extend them into the future.

That is unfair and unacceptable at this point.