

AN ADDENDUM

**TO THE MARCH 14 2007 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**

April 11, 2007

On March 14, 2007, The Consumers' Association of Canada, Saskatchewan Branch, made a presentation before The Saskatchewan Rate Review Panel with respect to the rate adjustment application submitted by the SGI/Auto Fund. We identified several areas of concern regarding CLEAR rated vehicles.

During the hearing the SGI/Auto Fund provided more information about Conventionally rated vehicles. CAC/SK decided it must also include those vehicles in its analysis of the Auto Fund's rate application. The CLEAR rated vehicles account for 80% of the Auto Fund's annual premium income, the Conventionally rated vehicles account for the remaining 20%. It was agreed CAC/SK would submit an addendum to its March 14 presentation and also clarify some issues that emerged during the hearing in the exchange of ideas, questions, and answers.

The driving factor behind our concerns is the manifest unfairness of the current premiums charged in Saskatchewan for automobile insurance. The record shows that there were 838,440 registered and insured vehicles in Saskatchewan at the time the rate application was prepared. Of this total, 66 per cent or 556,365 vehicles are classified as light vehicles (LV) by the Auto Fund and include passenger cars, vans, trucks and SUVs.

The extent of unfairness can be measured by the fact that 307,042 CLEAR rated vehicles are assessed excess premiums and another 232,755 vehicles are assessed insufficient premiums. 16,568 vehicles or 3 per cent of all CLEAR rated vehicles are assessed correctly and pay the proper premiums.

The other registered vehicles in Saskatchewan are classified as Conventionally rated vehicles. They include commercial and farm trucks, other commercial vehicles, taxis, buses, motorcycles, trailers, specialized vehicles, etc. This group comprises 282,075 vehicles or 33 per cent of all vehicles. Within this group, 140,461 vehicles are assessed excessive premiums, 45,352 vehicles are assessed insufficient premiums. 96,262 vehicles are assessed correctly and pay the proper premiums.

In summary, while the Auto Fund is now insuring about 838,000 vehicles, only 113,000 vehicles are rated correctly and pay the proper premiums. 725,000 vehicles are rated incorrectly and therefore the owners end up either paying too much or too little. (Sufficient information was not provided to permit us to calculate the amounts of the excess and deficiency premium payments.)

These numbers indicate there are 725,000 individual premium problems which must be addressed to re-establish the public's confidence in the fairness of the Auto Fund's rate structure. To its credit, the SGI/AutoFund recognizes this; its current application before the Rate Review Panel is designed to accomplish that task.

Owners of vehicles registered in Saskatchewan must purchase their automobile insurance coverage from the Auto Fund. It has the exclusive rights to provide automobile insurance in the province. The basic insurance policies offered to all its customers include coverage against vehicle damages, personal injuries, and third party liabilities. Customers have the option of choosing between no-fault or tort coverage with respect to personal injury claims. Less than 1 % of all customers have chosen the tort option. Customers can also purchase additional third-party liability coverage.

The annual fee payable to the Auto Fund is a composite of the vehicle registration fee, the prorated share of the Auto Fund's operating expenses, the issuer fees and the provincial premium taxes, and the basic insurance premium. The Auto Fund establishes the insurance premium on the basis of its experience with the risks attached to damage claims, personal injury claims, and third party liability claims.

We note from the Rate Proposal Document that the Auto Fund pools all its customers to determine third party liability premiums and charges everyone the same flat rate. It is not clear from the evidence how the Auto Fund pools its customers with respect to personal injury risks. It is, however, very clear that the Auto Fund operates with many pools to establish risk ratings with respect to damage claims.

The CAC/SK is pleased that the SGI/Auto Fund wants to fix the rating problems. We have some concerns about how the SGI/Auto Fund proposes to correct them.

The CAC/SK wants to be satisfied that the proposed premium changes will be fair in the sense that owners/drivers facing the same risks from operating their vehicles will pay the same premiums and likewise, those owners/drivers facing different damage and personal injury risks will pay different premiums for operating their vehicles.

1. CAC/SK is concerned that the current rate proposal may not accomplish that objective. We note from Page 5 of the Auto Fund's Rate Proposal Document that:

“rating rules are to be accepted by the panel as given”.

We are not certain what that means for the Rate Review Panel in its deliberations but we do not believe it precludes the CAC/SK from expressing its concerns about the procedures, including rating rules, used by the Auto Fund to determine risks and applicable premium rates in Saskatchewan. It is indeed possible that the current “rating rules” may have contributed to the very problems now before the Rate Review Panel.

We learn from the rate application documents that the Auto Fund separates all vehicles into two major groups; CLEAR rated vehicles and Conventionally rated vehicles.

The risk determination procedures for the Conventionally rated vehicles appear to follow standard risk rating practices in the automobile insurance industry. Risks are

determined on the basis of the insurance company's experience with respect to type of vehicle, use of vehicle, location, and the operator/owners' driving records. With this information the Auto Fund can determine the loss ratios for each sub group of vehicles and make necessary adjustments on the basis of individual driving records to determine the appropriate and fair premiums for each vehicle operated by its owner.

Lack of information supplied by the Auto Fund did not permit us to determine whether the Auto Fund applies the same approach to the risk determination for the Clear rated vehicles. We note that type of vehicle and driving records are used. Location and type of use of vehicles appear to be employed only for some farm vehicles but not for other Clear rated vehicles.

We find it hard to believe that the risks of operating a vehicle within Saskatchewan are the same regardless of location. The Auto Fund applies the location criterion in its rating of taxi premium rates by distinguishing between urban centres by size across Saskatchewan and distinguishing these taxis from taxis operating in non-urban locations. We find it puzzling that use of Clear rated vehicles, other than light farm vehicles, appears not to be employed at all in risk determination.

Without applying the same rating criteria across all vehicle groups, is it possible to determine the proper loss ratios for all Clear rated vehicles and set correct and fair premiums?

2. The CAC/SK is concerned that during 2006, 86.5 % of all insured vehicles were charged incorrect premiums in Saskatchewan. We assume there is a strong correlation between risks and premiums and that the reported number of incorrect premiums reflects a corresponding number of incorrect risk ratings rather than 725,000 mechanical billing errors.

We accept that at any given time a certain portion of all vehicles may not be rated correctly but 86.5 per cent appears excessive. Was 2006 an unusual insurance year or are the reported numbers in 2006 a result of "an unfairness creep" over a period of years?

We want to raise the possibility that the unfairness identified in the current rate application may have existed for some time. We would like the Rate Review Panel to review the extent and the magnitudes of possible unfair premium rates since its last rate adjustment application before the Rate Review Panel. The current rate application proposal does not appear to contemplate the possibility of immediate past inequities.

We urge the Rate Review Panel to address this issue, assess its significance and determine whether inter-temporal fairness considerations require rate adjustments in addition to those brought before the Panel by the Auto Fund in the current rate application.

3. The CAC/SK is not persuaded that the SGI/Auto Fund's concerns about "rate shocks" are sufficiently valid concerns to justify a "slow track approach" as recommended by SGI.

The SGI is the administrator of the Auto Fund. The Auto Fund was established to make certain that all vehicles registered in Saskatchewan carry sufficient insurance coverage. That task has been accomplished successfully. Furthermore, it is our understanding that the Administrator of the Auto Fund will seek to offer this insurance coverage in a cost effective, efficient, and equitable manner. That task is now subject to review.

The substance of the current rate application is clearly to address matters of equity and fairness, the Auto Fund's current rate structure, and how to credit customers who paid excess premiums and debit customers who did not pay sufficient premiums.

The first priority of the Administrator of the Auto Fund must be to correct the rate structure of the Auto Fund and restore fairness.

The second priority is to correct for current and past excess and deficient premium payments.

The stated concerns about "rate shocks" are both irrelevant and counter-productive in the context of addressing both of these priorities. Those concerns cannot and should not be used as reasons to postpone the necessary and required corrections to the current rate structure. Nor do they give rise to valid reasons to delay premium adjustments for past incorrect premiums or moving quickly to implement new and correct premiums in the present.

If the SGI believes that the timing and the speed of the required adjustments constitute legitimate business problems for the operations of the Auto Fund it will need to offer reasons other than those presented in its rate application document.

The corrections to the rate structure problems are best left for the Auto Fund to handle subject to an external review. We would like the expert consultant retained by the Rate Review Panel to review how the Auto Fund proposes to correct the rate structure and to assess the risk ratings and the rates during the next two years.

4. During the hearing on March 14 we raised the issue of the difference between a rate adjustment and SGI's current practice of offering rebates. The former requires approval by the Rate Review Panel, the latter appears to be at the discretion of SGI under the authority of *The Automobile Accident Insurance (General) Regulations, 2002*.

We have calculated the monetary value of the proposed rate reduction to be approximately \$ 26 million. We used the value of the net premiums written in 2005 and applied 5 % to that value. (No information about the 2006 premium income was

available). We made no allowances for the non-insurance portions of the total premiums; hence our estimate may be on the high side.

During the presentation by SGI on March 14 under the heading of “Auto Fund Customer Initiatives” it listed \$ 44 million in rebates in 2006. We have determined that rebate was based on a formula of an 8 % reduction in the “*scheduled premium amount for each vehicle insured*” during 2005. (Sect 9.22 of *The Automobile Accident Insurance (General) Regulations, 2002.*) We have also determined that the proposed \$ 100 million rebate in 2007 is based on a rebate of 16.839 % of the “*scheduled premium amount for each vehicle insured*” during 2006. (Sect 9.23 of *The Automobile Accident Insurance (General) Regulations, 2002.*) The total rebates in 2006 and 2007 will be \$ 144 million.

How will the rebates of 2006 and 2007 be recorded in the annual financial statements of the Auto Fund? Customers paid their required premiums during 2005 and received rebates in 2006 on premiums paid to the Auto Fund the previous year. Will the \$ 44 million rebate paid out in 2006 but based on the Auto Fund’s 2005 premium income trigger a restatement of the Auto Fund’s annual financial statement as of December 31, 2005 and adjustments in the fees paid to the issuers and the premium taxes paid to the provincial government in 2005? The same questions will apply to the 2007 rebate with respect to the 2006 financial statement of the Auto Fund.

We learned also that SGI has introduced SDR and BR discounts. The value of these discounts amount to \$ 132 million since 2002 according to numbers presented by SGI. The determination and calculations of these discounts are also made under the authority of *The Regulations* cited above. The SDR and BR discounts are offered to customers on the basis of their driving records or driving practices and will therefore affect the net annual premiums paid by different customers. We assume that the annual financial statements of the AutoFund report the annual premium income net of these discounts and they therefore are not included in determining issuer fees and provincial premium taxes.

When we add the monies involved in the proposed rate adjustments for 2007, the SDR and BR discounts granted since 2002, the rebate paid out in 2006 and the proposed rebate of 2007, but not including \$ 35 million set aside in a Redevelopment Reserve, we arrive at a sum of \$ 302 million. That is a significant sum and is a matter of concern to the CAC/SK for several reasons:

First, only \$ 26 million of this sum is subject to review by the Rate Review Panel. ***The remaining \$ 276 million or 91.3 % of the total refund to its customers is administered by the Auto Fund at its sole discretion without a review by an external agency.***

Second, we note that SGI offered \$ 73 million in discounts in 2005 and 2006 in addition to \$ 44 million in rebates. In 2007 it proposes \$ 100 million in rebates and a 5 % general discount (rate reduction) but no SDR and BR discounts. In previous years it offered SDR and BR discounts but no rebates or rate adjustments.

What determines the annual total sum of discounts, rebates, and rate reductions and how does SGI determine the manner in which this sum should be split among the several ways it can be distributed to the customers of the AutoFund?

Third, the matter of how these reductions are distributed is clearly a matter of great significance to the customers of the Auto Fund. The benefits received by the customers may depend upon whether SGI decides to structure it as a rebate, a discount or a rate adjustment. We assume a 5 % rate adjustment is applicable to every customer of the Auto Fund without qualifications. We know that SDR and BR discounts are structured for the benefit of specific customer groups and not applicable to every customer. We have reviewed carefully the language of Sections 9.22 and 9.23 of *The Automobile Accident Insurance (General) Regulations, 2002* and believe that the rebates payable to “eligible insured” persons means every customer of the Auto Fund is entitled to the rebate except those specifically excluded because of prior convictions under the *Criminal Code*. If this is the correct interpretation one is left to wonder why the Auto Fund prefers to offer some refunds in the form of rate rebates and bypass a review by the Rate Review Panel and others in the form of rate reductions requiring a formal review.

Is the choice of offering discounts, rebates or rate reduction a matter of internal rules developed by the Auto Fund or are there other important factors at play in this decision? Should this choice be subject to review by the Rate Review Panel, the Superintendent of Insurance or another body at arms length from SGI and CIC?

Fourth, we have some concerns about the manner in which the rebates are distributed to the Auto Fund’s customers. We know that rebate cheques issued by MPI in Manitoba resulted in a significant number of cheques not being cashed for various reasons. We expect similar results will occur in Saskatchewan.

The CAC/SK would like the Auto Fund to consider offering rebates as automatic reductions against future premium payment when they come due.

We expect that will cover in excess of 90 per of the rebates with savings to the AutoFund and convenience to the customers. Cheques would of course be offered to customers who cease to register their vehicles with the Auto Fund.

5. In section #3 above we referred to the urgent need to make corrections for the excess and deficiency rate premiums identified in the rate application document. In section #4 above we have identified the sum of monies returned by the Auto Fund to its customers since 2002.

We assume that none of the monies paid back by the Auto Fund to its customers reflects a refund of the excess premium payments. CAC/SK wants to know the total estimated

amount of the excess premiums and how the Auto Fund intends to handle this adjustment problem.

We would also want to know the total amount of deficiency payments during the same time period and how the Auto Fund intends to handle the necessary premium adjustments for the customers who did not pay sufficient premiums.

We believe fairness requires the Auto Fund to address these issues. To ignore them and not refund the excess premium payments or to fail to levy surcharges to cover the deficiency premium payments means selected groups of customers of the Auto Fund will be asked to carry the necessary adjustment burden of subsidizing the group of customers who did not pay sufficient premiums.

6. The CAC/SK presentation on March 14 and this addendum have focused on insurance issues related to damage claims because the information provided by the Auto Fund focused on this issue as the core of the rate adjustment application.

We are aware that personal injury and third-party liability claims also are important automobile insurance issues and cannot be ignored. The rate application does not provide much information about either issue. We know that the Auto Fund introduced the no-fault option to personal injury insurance coverage in 1995. We note its actuary recommended in 2005 that the Auto Fund could reduce the contingency reserves set aside to meet future personal liability claims. Otherwise no detailed information is provided on how the Auto Fund assesses customer risks for this coverage and how well it matches risks and rates.

We understand from the rate application document that the Auto Fund charges all its customers the same flat fee for the third-party liability insurance coverage. We can offer no opinions on this practice because the Auto Fund does not supply any additional information to justify this practice. We do not know if customers face similar or different risks to third-party liability events. We must presume the Auto Fund believes all its customers face similar risks and on that basis charges a uniform rate. Is this a standard practice followed by private and public automobile insurance across Canada?

We remain puzzled by the dearth of information about these two insurance issues. They are part of the basic automobile insurance policy offered by the Auto Fund to its customers. All are required to purchase the basic policy. A rate adjustment application covers the rate of the complete insurance package. We would therefore expect sufficient information to be provided on every component of the basic insurance package. The lack of information is unfortunate because it precludes informed opinions on some important aspect of the Auto Fund's insurance operations.

7. The CAC/SK would like the Auto Fund to establish performance benchmarks to allow the Consumers' Association of Canada, Saskatchewan Branch, on behalf of thousands of consumers, and individual consumers on their own behalf to assess on a regular basis the cost effectiveness and the efficiency of the Auto Fund's operations and the fairness of automobile insurance premiums available to its customers in Saskatchewan.

The Auto Fund is a unique automobile insurance firm. It is the sole provider of basic automobile insurance in Saskatchewan. It has a stable and captive customer base and does not face the commercial risks of privately owned insurance of losing customers to competing insurance providers. It is a Fund according to *The Automobile Insurance Act*. During the SGI presentation at the hearing on March 14 in Saskatoon it suggested the Auto Fund is like "a trust fund". It is treated differently from all other Crown corporations in terms of its financial relationships with the Crown Investment Corporation of Saskatchewan and is not required to meet a minimum ROE and pay dividends to CIC.

The Auto Fund has come a long way since its start in 1944. The CAC/SK has looked at its development since 1984. In that year it was separated from SGI and established as the Saskatchewan Auto Fund with its own assets. SGI was retained to act as the Administrator of the Auto Fund. The total assets on January 1, 1984 were listed at \$ 201.3 million with \$ 166 million of investments. Twenty one years later on December 31, 2005 the total assets had grown to \$ 1.2 billion which included \$ 1 billion in investments.

All of this has been accomplished without funding and financial support from provincial government sources or other public funds. The only source of external funding available to the Auto Fund is the annual premium income it receives from its customers. The only other sources of funding are internal to the Auto Fund like investment income and sale of parts from claim damaged vehicles. Clearly, the Auto Fund is a Saskatchewan success story as measured by its annual financial statements.

Many of the unique features of the AutoFund are shared with two other Crown insurance firms in Canada, MPI in Manitoba and ICBC in British Columbia. All other automobile insurance firms in Canada are either for-profit insurance firms or non-profit mutual/co-operative firms. We know that MPI has developed some external benchmarks to track its performance relative to SGI and ICBC. We also know that MPI has found it necessary to adjust and reclassify some of the reported numbers of its comparators to guarantee consistency of the comparisons over time.

CAC/SK has every reason to believe that SGI is attempting to administer the Auto Fund to ensure cost-effectiveness and efficiency in its operations and to develop a fair and equitable rate structure. Nevertheless, the current rate application is a sharp reminder that financial success is not a sufficient condition to guarantee overall good and acceptable performance. The rate application lends support for a thorough performance review and the development of measures to track performance in the future.

8. SUMMARY:

CAC/SK believes it is timely to ask whether the Auto Fund's chosen Rate Stabilization Reserves, its adopted Minimum Capital Test, and its target Rate of Return on its Investment portfolio are appropriate objectives at this time. On March 14, the CAC/SK asked why the Auto Fund's target rate of return on its investment portfolio generated a rate of return 300 basis points less than the rate of return achieved by the Saskatchewan Pension Plan in 2005. The response from the SGI official in attendance was simply that the Auto Fund is not a pension plan. That response missed the point completely.

We would like the Auto Fund to explain why it should not, as the exclusive provider of automobile insurance in Saskatchewan without any competition, pursue different investment strategies and objectives to increase its internal revenues. The current internal financial targets appear appropriate for private-for-profit insurance companies but may not be appropriate for a "Crown" insurance firm.

Setting of sub-optimal financial targets does not ordinarily encourage the pursuit of internal efficiencies and cost effectiveness. It may well prevent the Auto Fund from demonstrating the cost and efficiency advantages it should possess as a single exclusive provider of insurance policies with a stable and protected customer base.

External measures of fairness in risk ratings and rate settings are difficult to establish because all measures of fairness involve value judgements about what is "fair". Different groups, different companies, and different individuals will reach different conclusions about what constitutes fairness. For these reasons it may not be possible to rely on external comparisons to assess fairness because we are likely to end up comparing different definitions of fairness rather than comparing fairness itself.

Thus, the CAC/SK recognizes that reasonable consumers will have different perceptions of fairness. At the same time, we also believe that most consumers of automobile insurance in Saskatchewan, particularly those who pay excess premiums, will agree that the current rate structure is not acceptable.

The CAC/SK is of the opinion it is possible to establish premium fairness objectively only by requiring the AutoFund to set insurance rates such that owners/drivers in Saskatchewan facing the same risks from operating their vehicles will pay the same premiums and that owners/drivers facing different risks will pay different premiums.. This does not occur at the present time.

We believe premium fairness can be accomplished by establishing the damage loss ratios for all vehicles in each vehicle subgroup insured by the AutoFund in Saskatchewan adjusted for vehicle use and location. The final premium will also include an adjustment based on the owner's driving record. The evidence produced by the Auto Fund for this rate application clearly states that location is not employed by the Auto Fund and that use of vehicle applies only to Conventionally rated vehicles and some farm rated CLEAR vehicles.

CAC/SK would also like the Auto Fund to state clearly and unequivocally its risk and rating procedures with respect to personal injury insurance coverage and third-party insurance coverage and the reasons why current practices are appropriate for use in Saskatchewan.

Finally, we would like the AutoFund to advise its customers annually about the damage loss ratio for every vehicle owned by that customer and the premium payable on account of that ratio adjusted to reflect type of use, location, and driving records. Likewise, every owner should be advised about the premium charged on account of personal injury and third-party liability overages. The AutoFund should also include and record its normal operating expenses, the issuer fees and the provincial premium taxes with this information. CAC/SK would recommend that the annual premium calculations be tracked and made available to each owner with each annual insurance renewal.

The establishment of these notional accounts for each registered owner will enhance the transparency and accountability of providing automobile insurance services in Saskatchewan. These accounts can be used to track fairness and unfairness of risk ratings and premium rates on both a cross-sectional and a longitudinal basis.

These issues are important for consumers in Saskatchewan and the Consumers' Association of Canada, Saskatchewan Branch.