

# FACILITY ASSOCIATION

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**TO: MEMBERS OF THE FACILITY ASSOCIATION**

**ATTENTION: CHIEF EXECUTIVE OFFICER**

**BULLETIN NO.: F05-040**

**DATE: AUGUST 22, 2005**

**SUBJECT: NBIB DECISION ON COST OF CAPITAL IN  
FACILITY ASSOCIATION RATES**

The New Brunswick Insurance Board conducted a hearing June 27 - 29, 2005 to address two issues:

**Issue 1:** What should be the **appropriate return on equity** for automobile insurance companies doing business in New Brunswick? What **Premium to Surplus Ratio** is appropriate for New Brunswick? What **investments and related returns** should be credited to the policyholders in setting rates?

**Issue 2:** Should the rates for the business managed by Facility Association include a **recovery of the "Cost of Capital"**? If so, what would be considered a **proper rate of return** to recover this Cost of Capital?

Despite pre-filed evidence from the Board's economic advisor stating:

"The arguments used to justify a return to capital for a regulated enterprise apply equally to the Facility Association. If capital is provided to the operation of the FA then it has a cost like any other capital provided. To the extent that the cost of capital is borne either by the insurance companies through lower profits or regular policyholders cross-subsidizing FA rates through higher premiums, there is an undesirable element of subsidization. Markets perform best when participants bear the full cost of their choices. As a matter of principle, there should be recognition of the cost of capital and it should be at least as high as the rate for normal business. Given the larger risk, there are valid arguments to exceed the general ROE. I noted that a number of companies have written to the effect that they have not included the FA capital in their capital determination for regular policies."

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in a decision released July 25, 2005, the NBIB declined to allow Facility Association to include a cost of capital provision in its rates. The decision said, in part:

“The Board is of the opinion that the Facility Association was created on June 28, 1977 as a non-profit organization for the benefit of insurance companies who did not want to have high risk drivers in their books of business. Their part in the Facility Association was the price they had to pay for doing business in a regulated environment.”

The entire text of the decision is on the web at:

[http://www.nbib-canb.org/Decisions/PDF/ROE\\_and\\_FA\\_Decision\\_2005\\_06\\_27\\_E.pdf](http://www.nbib-canb.org/Decisions/PDF/ROE_and_FA_Decision_2005_06_27_E.pdf)

As a result, if members want to make a recovery of the cost of their capital that is used to support Facility Association premiums, they will have to request this cost element in their own voluntary market rate filings. The decision referenced above is silent on how such a request would be received by the NBIB.

David J. Simpson, M.B.A., FCIP  
President & CEO

*Please provide a copy of this bulletin to your CFO.*