

# New Brunswick Insurance Board

## DECISION

IN THE MATTER:

Of a rate revision application for the FACILITY ASSOCIATION  
With respect to automobile insurance rates for  
***PRIVATE PASSENGER VEHICLES***

Hearing Date: November 22 and 23, 2017  
Heard at Saint John, New Brunswick

**PANEL:**

Ms. Marie-Claude Doucet	Chair
Ms. Francine Kanhai	Member
Ms. Elizabeth Turgeon	Member

**APPEARANCES:**

**Applicant:**

**Facility Association**

Mr. Matt Hayes	Solicitor
Mr. David J. Simpson	President and CEO
Mr. Colin George	Vice President, Underwriting and Claims
Mr. Shawn Doherty	Senior Vice President Actuarial and Chief Financial Officer

**Intervenors:**

**Office of the Attorney General**

Mr. Michael Hynes	Solicitor
Ms. Maya Hamou	Solicitor
Ms. Paula Elliott	Consulting Actuary

**Consumer Advocate for Insurance**

Ms. Michèle Pelletier	Consumer Advocate
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Date of Hearing: November 22 and 23, 2017

Decision Rendered: December 15, 2017

## Summary

- [1] Pursuant to subsection 267.5(1) of the *Insurance Act*, R.S.N.B., 1973 c. I-12, the New Brunswick Insurance Board (the “Board”) convened a Panel of the Board to conduct an oral hearing (the “Hearing”) on November 22 and 23, 2017 at the offices of the New Brunswick Energy and Utilities Board, in Saint John. The purpose of the Hearing was to consider the rate revision application (the “Filing”) submitted by the Facility Association (the “Applicant” or “FA”) with respect to automobile insurance rates for private passenger vehicles (PPV) in New Brunswick. The FA is an unincorporated non-profit association to which every automobile insurer licensed in New Brunswick under the *Insurance Act, supra*, is a member. Under the *Insurance Act, supra*, the FA is required to provide automobile insurance to owners and licensed operators of automobiles who, but for it, would be unable to obtain such insurance and the FA shall carry out this obligation in the Province of New Brunswick.
- [2] In compliance with subsection 19.71(3) of the *Insurance Act*, the Board provided to the Office of the Attorney General (“OAG”), all documents relevant to the Hearing. Pursuant to subsection 19.71(4) of the *Insurance Act, supra*, the OAG intervened, made representations to the Panel, presented written and oral submissions, questioned the Applicant by way of written interrogatories and cross-examined the Applicant’s witness during the Hearing. The Consumer Advocate for Insurance (“CAI”) intervened as well, adopting the position of the OAG, presented oral submission and cross-examined the Applicant’s witness during the Hearing.
- [3] During the hearing process the Panel accepted the following exhibits from the Applicant and the OAG as part of the record as shown below:

<b>EXHIBIT</b>	<b>DESCRIPTION</b>	<b>DATE</b>
<b>1.a</b>	Facility Association PPV Rate Filing	Apr 15, 2017
<b>1.b</b>	Original Part 2a of 2	April 15, 2017
<b>1.c</b>	Original Part 2b of 2	April 15, 2017
<b>2</b>	Questions from NBIB	May 1, 2017
<b>3</b>	FA Response to NBIB	May 5, 2017
<b>4</b>	Questions from KPMG	May 18, 2017
<b>5</b>	FA Response to KPMG	May 25, 2017
<b>6</b>	Follow-up Questions from KPMG	June 5 2017
<b>7</b>	Additional Follow-up Questions from KPMG	June 5, 2017
<b>8</b>	FA Response to KPMG	June 9, 2017
<b>9</b>	Follow up Questions from KPMG	June 20, 2017
<b>10</b>	FA Response to KPMG	June 26, 2017
<b>11</b>	Revised Exhibits	June 30, 2017
<b>12</b>	KPMG Summary Review	July 13, 2017
<b>13</b>	Written Interrogatories Round 1 from OAG	Sep 8, 2017
<b>14</b>	FA Response to Interrogatories Round 1	Sep 15, 2017
<b>15</b>	Interrogatories Round 2 from OAG	Sep 29, 2017
<b>16</b>	FA Response to Interrogatories Round 2	Oct 6, 2017
<b>17</b>	FA Final Written Submission	Oct 20, 2017
<b>18</b>	OAG Final Written Submission	Oct 20, 2017
<b>19</b>	MCT Guideline dated January 1, 2016	Nov 21, 2017
<b>20</b>	Request for Final Revisions from NBIB	Nov 28, 2017
<b>21</b>	FA Response to the Request for Final Revisions	Nov 30, 2017
<b>22</b>	FA Response to Undertaking Requested by Panel	Dec 13-14, 2017

[4] On November 27, 2017 further to the Hearing, the Panel ordered the Applicant to provide revised overall indications for the impact of the following combination of two (2) changes:

- 1) Modify the pre-tax return on investment (“ROI”) from 0.79% to the ROI yielded using a mix of Government Bonds and Corporate Bonds supported by the investment portfolio distributions reported in MSA Researcher;
  - 2) Substitute the Applicant’s proposed adjustment factor of +1.2% to account for the effect of the Harmonized Sales Taxes (“HST”) change on Bodily Injury (“BI”) with an adjustment factor of +0.44%.
- [5] The required changes as per above result in an overall indication of 9.80%, a decrease of 5.30% in FA’s first alternative indication of 15.10%.
- [6] The Panel, after examining the evidence and submissions made by the parties, and after consideration of the testimony provided by witnesses during the interrogatory process and cross-examinations, determines that the rates proposed by the Applicant must be modified as set out below.
- [7] The Applicant is ordered to incorporate changes to the rate application as noted in paragraph [4] above and is **approved to adopt the average rate change of + 9.80%**.
- [8] The approved rates will be effective on April 1, 2018 for new and renewal business.

## **1. Introduction**

- [9] The Board is mandated by the Legislature with the general supervision of automobile insurance rates in the Province of New Brunswick. In order to fulfill that mandate, the Board exercises the powers prescribed by the *Insurance Act, supra*. One key responsibility for the Board is to ensure that rates charged or proposed to be charged are just and reasonable. Under the *Act, supra* each insurer carrying on the business of automobile insurance in the province must file with the Board the rates it proposes to charge once every 12 months from the date of its last filing. If the proposed rates reflect an average increase greater than 3%, or if the insurer files rates more than

twice in a period of twelve months, the insurer will be required to appear before the Board to provide justification.

## **Procedural History**

[10] The Applicant filed a rate revision application for the PPV category on April 18, 2017, seeking an average rate increase of 15.1%.

[11] The Board issued a Notice of Hearing on August 1, 2017 and convened a Panel of the Board to conduct an oral hearing on the matter. The Office of the Attorney General and the Office of the Consumer Advocate for Insurance both provided notice of their respective intention to intervene in the rate hearing.

[12] Prior to the Hearing, the OAG submitted two sets of interrogatories to the Applicant, to which answers were provided. Furthermore, pre-hearing written submissions were provided by those parties to the Board.

[13] The Panel allowed the examination and cross-examination of actuarial witnesses by the parties during an oral hearing held on November 22 and 23, 2017. Mr. Shawn Doherty testified as the expert witness for the FA and Ms. Paula Elliott appeared as the expert witness for the OAG. Both witnesses were actuaries, and no other witnesses were questioned at the Hearing.

[14] Finally, the Panel heard brief closing submissions from the Applicant, the OAG and the CAI following the cross examinations.

## 2. Evidence and Positions of the Parties

### Facility Association

- [15] The Applicant's Filing forms the main portion of its submission and the evidence before the Panel.
- [16] Pursuant to its mandate, the Board then proceeded to investigate the rate filing submitted by the FA in order to determine whether the proposed rates are "just and reasonable".
- [17] The FA presented a Filing to the Board with an overall indication of +20.60% and proposed to select an average rate change of 15.10% based on its first alternative indication. Following are the changes proposed to the existing rates by coverage:

Bodily Injury ("BI")	+ 22.00%
Property Damage ("PD")	+ 22.00%
Property Damage – Direct Compensation ("DCPD")	- 6.40%
Accident Benefits ("AB")	+ 25.70%
Collision	- 4.10%
Comprehensive	+ 2.00%
Specified Perils	- 13.00%
All Perils	- 2.10%
Uninsured Auto (UA)	+ 8.70%
<u>Underinsured Motorist – SEF44</u>	<u>- 6.50%</u>
<b>Total</b>	<b>+15.10%</b>

- [18] The rates contained in the Filing are produced assuming a target return on equity of 12%, a pre-tax 0.79% return on investment and a 2:1 premium to surplus ratio. Proposed average rates would increase from the current average of approximately \$1,695 to approximately \$1,867.

[19] The Applicant submits that the Filing was prepared utilizing sound actuarial methods and practices and that the assumptions contained therein are reasonable and that the Filing has been prepared in accordance with the filing guidelines issued by the Board.

## **Office of the Attorney General**

[20] The OAG was provided with the Filing and all related documents. The OAG was also given the opportunity to further query the Applicant through a written interrogatory process which provided for two rounds of interrogatory questions and answers. At the conclusion of the interrogatory process, the OAG made a final written submission to the Board summarizing its position. Finally, the OAG was provided an opportunity to present its evidence through the interrogation of its witness, actuary Ms. Elliott, and to cross-examine Mr. Shawn Doherty, the witness for the FA, at the Hearing held on November 22 and 23, 2017.

[21] In its final written submission, through a report by consulting actuary Oliver Wyman (OW), the OAG challenged the Applicant's position on the following issues as summarized at page 36 of the Record [Exhibit 18]:

It is our opinion that in determining whether the PPV rates proposed by FA are just and reasonable, the Board should give consideration to the reasonableness of alternative assumptions and adjustments to FA's rate level indication calculations that we discuss in this report. In the Interrogatories dated September 29, 2017 (Question #19), we asked FA to provide an alternative rate level indications based on the following combination of assumptions:

1) Bodily Injury ultimate loss amounts based on the B-F Method, as well as the development factor 1.0046 for the 24 to 30 incremental period (which excludes the high point, similar to FA's exclusion of the low point for the 18 to 24 month period) for the Link Ratio Method.

2) Bodily Injury frequency trend rate of -2.4%, beginning January 1, 2011.

3) Disability Income frequency trend rate of -2.4%, beginning January 1, 2011.

4) HST adjustment factor for Bodily Injury of 1.0044.

5) In the calculation of the complement of credibility, no adjustment for the difference between the FA's estimate of its rate level change need and the Board's prior approved rate change, as well as the application of the alternative trend rates we suggest.

6) An offsetting net finance fee provision of 2.5%, including consideration of the delay in receipt of premiums.

7) A target pre-tax ROI of 1.79%.

8) A target after-tax ROE of 9%, consistent with the Board's prior Decisions for FA private passenger vehicles.

[22] Finally, the OAG submits to the Board that should it find the alternative assumptions presented by its expert actuary more reasonable than those presented by the Applicant, and that the Board should direct the Applicant to re-state the above noted rate level change indications and consider those re-stated indications in reaching its decision on the present application.

### **Consumer Advocate for Insurance**

[23] The CAI challenged the evidence related to the target return on equity provided by the Applicant and presented the Board with an oral submission at the Hearing.

[24] The CAI supports and adopts the position of the OAG in relation to the Filing.

### **3. Analysis and Reasons**

[25] The Panel has reviewed all of the written evidence before it, along with the arguments of each parties, *viva voce* evidence provided at Hearing, and submissions of the parties.

[26] Under examination, the witnesses for both parties testified to the validity of their assumptions and actuarial methodologies and under cross-examination answered questions challenging their positions, notably on the appropriateness of the actuarial approaches and methodology used in light of the limited data available.

[27] In its decision, the Panel considers the testimony of the expert witnesses trained in the actuarial sciences that was presented to the Board during the Hearing.

[28] In the present matter, the Panel of the Board determines that the Facility Association must amend some of the initial assumptions, calculations and methodology used in its Filing. The Applicant was therefore ordered to provide the Board with the calculation resulting from those amendments on November 28, 2017.

[29] The Panel addresses each issues individually below:

***1) Estimation of Ultimate Loss Amounts***

[30] In arriving at ultimate losses estimations, experts in actuarial science can consider various estimation methods, notably the Link Ratio Method (LRM, also known as the Incurred Loss Development Method), the Expected Loss Ratio Method (ELR), the Bornhuetter-Ferguson Method (BF), the Weighted Method, and the Zero Incurred But Not Reported Method (Zero IBNR). Each of these five methods has its own strengths and weaknesses, hence the reason for actuaries adopting different methods in calculating the ultimate losses.

[31] In order to estimate its ultimate PPV losses, the Applicant selected ultimate losses by accident half-year and coverage, evaluated as of September 30, 2016. Having considered the above noted loss estimation methods, the Applicant subsequently made its selection of the ultimate loss for every accident half-year.

[32] The OAG disagrees with the methodology utilized by the Applicant, more specifically with (1) its selection of loss development factors for the LRM and (2) its selection by accident half-year further to an evaluation of all five methods.

• **Loss Development Factors Selected for the Link Ratio Method**

[33] In its selection of the loss development factors for the LRM, the Applicant used the weighted average of the last 10 incremental factors for the six-month incremental periods through 60 months, excluding the 18 to 24 months period due to its low point. As for the 60 to 72 months period, the weighted average of the last 10 incremental factors was selected, excluding the high and low points. Finally, for the period after 72 months, the factors were selected based on industry experience.

[34] The OAG takes issue with the selection of loss development factors for the period of 24 to 30 months for the reason that the Applicant did not exclude any data points despite the sharp decline in reported losses at 24 months and the sharp increase at 30 months for accident half-year 2010-1. The FA argues that its selections are reasonable, adding that the three most recent link ratios proved to be higher than the selected factor.

[35] The OAG submits that it would have been a more reasonable approach to exclude the two above noted data points given that for two of these three points, the volume of losses were relatively low, and argues the likelihood of random variation being the cause. Moreover, the OAG suggests that for the Applicant to rely on only three data points in support of its loss development factor selection is inconsistent with its use of long body of experience in selecting trend rates.

[36] In its submission, the Applicant explains that the reason for including all data points for the period of 24-30 months is that excluding the development factor at 30 months from the selected average would have the effect of decreasing the average to 1.0046. The Applicant submits that further to a review, the Applicant selected the factor of 1.0577 (the default link ratio selection for the New Brunswick PPV BI coverage as selected by FA's appointed actuary) considering the apparent change over the most

recent three data points (1.0604, 1.2285 and 1.0666) which are higher than its selected link ratio.

[37] Though both the positions of the FA and the OAG are acceptable in the circumstances, the Panel finds the Applicant meets its onus of demonstrating the reasonableness of its selection of loss development factors for the Link Ratio Method and therefore accepts FA's selections.

**•Selection of Method and Ultimate Loss Amounts**

[38] The Applicant presented the Panel with the actual reported losses for BI to date, as well as the ultimate loss amounts for experience period 2011 to 2015 assessed under the five different loss estimation methods, and its selected method by accident half-year. The evidence presented shows that the Applicant selected the LRM for data points 2011-1 to 2012-1, but then alternates its selection between the Weighted Method and the Zero IBNR Method, the highest ultimate claims resulting methodology always being selected.

[39] The OAG argues that selecting the methods yielding the highest result in ultimate claims results in a total of ultimate claims of 15.911 million, which is higher than the total achieved by selecting any other loss estimation method for all half-years. This is depicted at Table 4 of the OAG's Final Submission (page 1108 of the Hearing Record). The OAG further submits that the Zero IBNR Method's selection for periods 2012-2, 2013-2 and 2014-2 does not take into consideration the historical pattern of negative loss development of the Applicant and the Industry; the result of ultimate losses estimates being higher for the above noted years than the historical experience's ultimate losses.

[40] Finally, the OAG argues that due to the relative maturity of the reported losses (accident years 2011 to 2015), the weights assigned to the ELR Method for the Weighted Method appear to be disproportionately high. The OAG points out that the similarity of estimates between the LRM and the BF Method and the actual loss

amounts reported demonstrates the same. The OAG submits that due to the maturity of the data, it would be more appropriate to attribute more weight on the actual claim experience that has emerged (using the Link Ratio Method) as opposed to the expected claim experience (using the ELR Method). Consequently, the OAG submits that it would be more reasonable to apply the BF Method (a weighted average of the LRM and ELR Method) for all accident half-years.

[41] The Panel rejects the recommendation of the OAG to select the BF Method for all accident half-years, given that for years 2012-1 through 2014-2, the application of the BF Method with a cumulative development factor below 1.0 yields estimates of ultimate losses falling outside the range provided with the application of the ELR and the LRM.

[42] At the Hearing, the witness for FA testified that the default method used by its appointed actuary for the most recent years is the Weighted Method. However, due to larger individual claims to FA's portfolio in 2012-2, 2013-2 and 2014-2, FA's appointed actuary applied its judgement to substitute the Weighted Method with the Zero IBNR Method for those specific year. The rationale behind the use of the Zero IBNR Method for those half-years is that in those circumstances, the reporting and evaluation of these larger individual claims will be done more accurately than in the case of smaller claims. Therefore, the case reserves set aside for larger claims more accurately reflect the ultimate amount of the claims. Consequently, in the opinion of FA, the selection of the Zero IBNR Method should provide a better estimate of the ultimate loss amount. On this specific point, Mr. Doherty testified at the Hearing :

[...] there are large losses involved in there. And the actuary, when he looked at the reported activities to date, viewed the large loss activity as something that he can rely on more for an estimate of the claims liability that's associated with it. And he is putting more reliance on that, so he felt it was appropriate to include no additional IBNR because he felt the case reserves are the best estimate of the claims liability.

[...]

And again, it is large loss activity and judgmental selection based on a view of case reserve adequacy.

[November 22, 2017 Transcript, page 85 and 86]

[43] In light of the above, the Panel is satisfied with the arguments provided by FA at the Hearing and finds the Applicant's exercise of judgement to be reasonable in the circumstances.

## ***2) Selected Loss Trend Rates***

[44] The selection of loss trend rates requires the analysis of past data and the application of professional judgement in order to select trend rates for each coverage by separately selecting and then combining frequency and severity trend rates, representing past experience and future expected results.

[45] In its loss trend analysis, the Applicant used a regression model applied to industry PPV experience over the past 20 years.

[46] The Applicant proceeded to make its trend selection by selecting the same past and future trends for most coverages. In those instances, the Applicant opted to apply June 30, 2016 as the cut-off date in the application of the past and future trend rate. That said, for the coverages where the Applicant chose to use different trend rates for past and future, different cut-off dates were selected. Notably, the Applicant selected December 31, 2011 as the cut-off date for BI frequency.

### ***• Bodily Injury - Frequency***

[47] The Applicant and the OAG used different models to support their respective positions in terms of frequency trend rates for BI. In the regression analysis of its estimate of Industry PPV ultimate claim counts over a 20-year period ending June 30, 2016, the Applicant suggests the use of three experience periods: (1) 1996 second half-year (1996-2) to 2003 first half-year (2003-1); (2) 2003 second half-year (2003-2) to 2011 second half-year (2011-2); and (3) 2012 first half-year (2012-1) to 2016 first half-year (2016-1). While the OAG agrees with the frequency rate selected for the period of

1996-2 to 2003-1, it disputes the segmentation of periods used by the Applicant for periods following the July 1, 2003 Minor Injury Regulation (MIR) Reform, as well as the trend rates applied to the period between 2011 to 2015. Below are the frequency trend rates by period selected by the Applicant for the period following the 2003 MIR Reform:

<b><u>Experience Period</u></b>	<b><u>Trend Rate Selected</u></b>
2003-2 to 2011-2	-7.10%
2012-1 to 2016-1	0.00%

[48] The OAG notably disagrees with the frequency trend rate selected by FA for the 2012-1 to 2016-1 period, as it argues the Industry data for 2015-2 and 2016-1 demonstrates the lowest frequency rate over the last 20 years.

[49] Hence, the OAG argues that the frequency trend for BI will continue to go on to decrease, while the FA had selected a frequency trend rate of 0.00%, as the p-value indicates that it cannot reject such a trend level. The OAG also points out in its final submission (Exhibit 17, pp. 1115-1116 of the Record), that the data that has emerged since June 30, 2016 (released in May 2017) shows that the pattern of decline persisted, with the exception of the 2015-1 data point, which the OAG attributes to the frequent snow storms and abnormally high snow fall in New Brunswick over this period and possible volatility in the data. The OAG submits that the data point 2015-1 should therefore have been excluded by FA in its regression analysis.

[50] As for the segmentation period, the OAG additionally suggests that segmenting the post reform periods as follows to be more appropriate: (1) 2003-2 to 2010-2; and (2) 2011-1 to 2016-1<sup>1</sup>. This segmentation stems from OW's fitted frequency rates obtained from a regression model over the second period noted above that resulted in significant p-values and fitted values that is argued by the OAG to be closer to the actual frequencies than those selected by the Applicant. However, the Panel was not provided with the details or statistical support of OW's modelling.

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<sup>1</sup> 2015-1 data point removed from regression analysis due to abnormally high snowfall.

[51] The Applicant provided the Board with details of its regression model (Exhibit 11, page 795 of the Record), which demonstrates that the data point 2015-1 does not stand out as an outlier, falling within +/- 1 standard deviation of zero, despite the large amount of snow fall that occurred during this period. FA also demonstrated strong statistical fit of its model, with an adjusted R<sup>2</sup> of 0.9687. At the Hearing, Mr. Doherty testified to the following:

I don't believe that two individual data points leads me to draw it to any conclusion. And again, when we are modelling – I'm satisfied with our bodily injury frequency modelling, particularly when you put it together with the severity. So if you look at the severity at the same time you have got 2015 H2 and 2016 H1 as being two of the highest levels that we have had in quite a while. So when you marry those two things together, we get a very good fit in the loss cost like I showed at the beginning of my opening statement.

So to me it's not only modelling frequency and then ignoring severity, you have to take the two of them in to consideration, because the ultimate goal here is to model loss costs.

[November 22, 2017 Transcript, page 103]

[52] The Panel determines that both approaches used by the Applicant and the OAG are acceptable and depend on the application of professional actuarial judgment and practice. That said, it is the Panel's view, based on the evidence presented, that the frequency trend of 0% selected by the FA for the period of 2012-1 to 2016-1, supported by its strong model, is reasonable in the circumstances. The Panel therefore accepts the cut-off periods adopted by FA as well as its selection of 0% as the future frequency trend rate for BI for the 2012-1 to 2016-1 period.

• **Accident Benefits - Disability Income**

[53] As for the frequency trend rates for BI, the Applicant based its regression analysis for AB - Disability Income ("DI") over a 20-year period, but did a four-period segmentation: (1) 1996-2 to 1999-2; (2) 2000-1 to 2003-1; (3) 2003-2 to 2008-2; and (4) 2009-1 to

2016-1. Below are the frequency trend rates by period selected by the Applicant for the period following the 2003 MIR Reform:

<u>Experience Period</u>	<u>Trend Rate Selected</u>
2003-2 to 2008-2	-8.40%
2009-1 to 2016-1	0.00%

[54] The OAG disagrees with the Applicant's frequency trend selection of 0.00% for the experience period of 2009-1 to 2016-1. The OAG suggests to select the frequency trend rate of -2.4% as indicated in the FA model because it displays a strong fit.

[55] The FA overrode its modeled frequency trend rate of -2.4% to judgmentally select 0.00%. The expert witness for the Applicant presented solid evidence in support of the strong correlation between the AB-DI coverage and other coverages' (i.e. BI, AB - Medical and Collision) frequency. The design matrix presented by the Applicant shows a correlation of above 98% between the Industry PPV BI and AB-DI coverages (page 932 of the Record).

[56] The Panel finds that the Applicant reasonably applied its judgement in the selection of the AB-DI frequency trend rate of 0% for the time period of 2009-1 to 2016-1.

### **3) HST**

[57] As the HST increased from 13% to 15% on July 1, 2016, resulting in an increase of +1.77%, the Applicant applied an adjustment of +1.77% to all coverages, with the exception of AB and BI for which it applies an adjustment of +1.20%. The rationale of the Applicant is that HST applies to approximately 2/3 of the total AB costs due to the AB-DI sub-coverage not being subject to HST; the same assumption is selected to be applicable for BI.

[58] The OAG disagrees with the Applicant on the application of an adjustment of +1.20% for the BI coverage. Particularly, the OAG refers to the New Brunswick Closed Claim Study based on data collected and validated by the General Insurance Statistical

Agency (GISA), according to which 75% of the BI costs were attributed to heads of damages not subject to HST. Hence, as only 25% of BI costs are subject to HST, the OAG suggests that the adequate adjustment for HST for BI would rather be of +0.44%.

[59] On this issue, the Panel rejects the argument of the FA on the application of an adjustment of +1.20% on the BI coverage, as it finds the position of the OAG to be better supported. The Panel therefore orders the application of +0.44% adjustment for HST for BI.

## ***2) Complement of Credibility***

[60] In its written submission, the OAG disputes the methodology utilized by the Applicant for the calculation of the complement of credibility as it relies on the rate inadequacy it believes existed in the current rates at the time they were implemented (the difference between the rate level indication and the rate level change approved by the Board).

[61] The OAG submits that while the FA's March 2016 Filing showed a rate indication of +4.1%, its proposed rate change of +3.0% was approved by the Board *without review or investigation*. The OAG goes on to argue that, FA's complement of credibility therefore carries over the difference between the 3.0% approved by the Board and the rate indication of +4.1%, despite the Board never accepting FA's rate level indication nor its target ROE.

[62] In its submissions, FA states that it did not rely on rate inadequacy existing between FA's previous year's rate indication and the approved rate. The Applicant specified in its submissions, as well as during the Hearing, that in this filing, it relied on projected indemnity loss ratio assumed to reflect underlying rates (Exhibit 18, page 1138 of the Record). During the Hearing, Mr. Doherty testified on the methodology used by FA: *"We are bringing forward a projected loss ratio from our previous filing and we are adjusting it for subsequent rate changes and we are adjusting it for claims trend to*

*move it to the future average accident date and for reflecting premium trends between those two filings” (November 22, 2017 Transcript, page 46).*

[63] During her testimony Ms. Elliott, expert witness for the OAG, did not raise any concerns or issues with the above noted approach taken by the Applicant on the complement of credibility and agreed that it automatically carried through based on the Panel’s decision on trends.

[64] In light of the Panel’s agreement with the Applicant on its selected trends, the Panel accepts the complement of credibility as calculated and adopted by FA.

[65] On the argument presented by the OAG in its written submission, the Panel wishes to clarify that although no hearing was required for FA’s March 2016 rate application, the Board performs an internal review and investigation of each complete filing, including its rate indication, through Board staff and consulting actuaries. Hence, although no hearing was triggered, through its rigorous internal process, the Board had approved FA’s selection, as well as its indication, which it had determined were just and reasonable.

### ***3) Finance Fee Revenues***

[66] FA’s policyholders have the option of a monthly payment plan in exchange for finance fees. The issue raised by the OAG on this point is that FA does not reduce its expense ratio in order to reflect the finance fees revenue. As this cost to policyholders and the revenue stream associated with it to the servicing carriers is not subject to sharing and does not form part of the Applicant’s operations, the Applicant did not factor this revenue into the indication for the purpose of this rate application.

[67] The position of the Applicant is that this revenue is collected and retained by servicing carriers, and not by FA. In its evidence (Exhibit 14, pp. 948 and 949 of the Record), the FA states that while Co-operators, its smaller carrier, does not charge a premium finance fee, its two larger carriers, RSA and Intact, charge a fee of 6%. FA estimates

that this 6%, as a percentage of premiums, is equivalent to an effective interest charge of 16.8% for new business.

[68] The OAG submits that in New Brunswick, premium financing fees is typically of 3% and points out that Intact and RSA, also offering the monthly payment plan option to their non-FA policyholders, to whom they only charge a rate of 3%. The OAG suggests that the discrepancy in fees between the FA and non-FA policyholders constitutes unfair treatment of FA's policyholders.

[69] FA established that it did not include in its rate indication any expenses or revenues related to financing fees. The Applicant has satisfied the Panel that it sensibly treated the financing fees in its rate indication and did not infringe the current filing guidelines. Further to the Panel's request at the Hearing, the Applicant also confirmed to the Board on December 14, 2017 (Exhibit 22) not having any influence over the premium finance fees with Servicing Carriers.

[70] Extensive testimony has been provided to the Panel at the Hearing on the issue of premium financing fees. The Panel therefore makes a recommendation to the Board to review this issue in order to consider whether it falls under the jurisdiction of this Board and if so, how premium financing fees should be treated in future filings.

#### ***4) Profit Provision***

[71] For the calculation of its overall rate level change need, FA includes a profit provision targeting a return on equity (ROE) of 12%, a premium to surplus ("P/S") ratio of 2 to 1, as well as a pre-tax return on investment (ROI) of 0.79% for cash-flow and surplus.

##### ***• Selection of pre-tax Return on Investment***

[72] The process of developing rates that are just and reasonable requires rate applications to account for the revenue received from sources other than directly from policyholders. One source of these funds is investment income that is received on

surplus funds held by insurers. Generally, these surplus funds stem from two sources: short-term cash flow and accumulated equity (surplus) and are invested using different approaches, i.e. short-term and long-term respectively. Generally, the higher the overall investment return, the lower the overall rate indications.

[73] The Applicant prepared its Filing by selecting a pre-tax return on investments (ROI) of 0.79% for cash flow and surplus. This ROI is assumed by the Applicant on the basis of an estimated return on a risk-free portfolio of investments. FA argues that this rate matches the projected yield curve of the Government of Canada. FA further states that it does not attribute the actual investment income that insurers earn with funds associated with policies written by FA in the rate setting process, given investment funds are actually held by its member insurers.

[74] The OAG submits that the 0.79% ROI selection is very low in comparison to the assumed ROI of other insurers within their rate filing and what was approved by the Board in the FA filing for Commercial Vehicles and suggests the Board should direct the Applicant to increase its filed pre-tax ROI by one percentage point, to 1.79%.

[75] The Panel agrees with the OAG's argument that FA's assumed ROI is low and that the Applicant should assume a return on investment rate higher than the estimated return of a risk-free portfolio. That said, the Panel rejects the OAG's suggestion to direct the Applicant to simply increase its ROI by one percentage point.

[76] On the issue of the assumed ROI, as per our Request made to FA on November 27, 2017, the Panel directs the Applicant to modify its assumption such that it relies on :

- a) the proportion of government bonds versus corporate bonds as reported in MSA Researcher, B04 – Total Canadian Property Casualty Industry;
- b) the Bank of Canada selected marketable bonds average yields for 1-3 year, 3-5 year, 5-10 year and over 10 year as at December 30, 2016;
- c) the Bank of Canada selected treasury bill yields for 3 months as at December 30, 2016;

- d) Corporate bonds nominal yield to maturity compounded semi-annually as at December 31, 2016 (as available in the CIA Report on Canadian Economic Statistics 1924-2016); and
- e) Investment expenses at 0.15%.

[77] Based on the above, the Panel orders the Applicant to use an assumed ROI of 1.91%.

• **Selection of target Return on Equity**

[78] The OAG objects to the use of a target ROE of 12% by FA stating that in prior PPV decisions involving FA, this Board had issued lower after tax ROE than the 12% selected by the Applicant. The OAG points to the Decisions of the Board in two FA's PPV rate filings, dated March 2010 and August 2011, whereas the proposed rate change filed by FA was based on a target after-tax ROE of 9%.

[79] Each decision of the Board or a Panel is stand alone and reflects considerations that are before that tribunal at the relevant time. Future Panels may consider, but are in no way bound by prior determinations. In 2010 and 2011, questions and concerns were being considered by the Board in respect of the FA market in New Brunswick and the availability of alternatives to FA. These are not live considerations in front of this Panel.

[80] In light of the higher risk portfolio of the Applicant, the Panel considers a target ROE of 12% to be reasonable in the development of its rate indications.

• **Premium to Surplus Ratio**

[81] The Applicant raises the following concern during the Hearing procedures with regard to the relation between ROI and the P/S assumption:

Note that as the capital assumption was not changed, the assumption set above is not consistent with the capital assumption (the capital assumption assumes an investment portfolio of securities free of default risk, whereas the ROI assumption above explicitly assumes 41% of the investment portfolio is invested in securities with default risk).

[82] The Panel understands that a higher investment risk would lead to a higher need for supporting capital, which would result in a lower P/S ratio, all other assumptions remaining unchanged. The Panel has determined that the P/S ratio assumption of 2 to 1 in combination with an ROI of 1.91% and a target ROE of 12% are reasonable in light of the filing practices currently observed in the New Brunswick PPV insurance market.

#### **4. Decision**

[83] For the reasons set out above, the Board finds the Applicant's Filing not to be just and reasonable in its entirety and therefore orders the following changes to be made:

- 1) Modify the pre-tax return on investment ("ROI") from 0.79% to the ROI yielded using a mix of Government Bonds and Corporate Bonds supported by the investment portfolio distributions reported in MSA Researcher;
- 2) Substitute the Applicant's proposed adjustment factor of +1.2% to account for the effect of the HST change on Bodily Injury with an adjustment factor of +0.44%.

[84] The impact of these changes will be to decrease the overall rate indications from an average increase of +15.10% to an average increase of +9.80%.

[85] The Applicant is ordered to incorporate changes to the rate application as set out in paragraph 83 above and is **approved to adopt the average rate change of +9.80%**.

[86] The approved rates will be effective on April 1, 2018 for new business and renewal business.

Dated at Saint John, New Brunswick, on December 15, 2017

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Marie-Claude Doucet, Panel Chair  
Chair, New Brunswick Insurance Board

WE CONCUR:

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Francine Kanhai, Board Member

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Elizabeth Turgeon, Board Member