

# New Brunswick Insurance Board

## DECISION

IN THE MATTER:

Of a rate revision application for the FACILITY ASSOCIATION

With respect to automobile insurance rates for

### *COMMERCIAL VEHICLES*

Hearing Date: April 20, 2017

Heard at Saint John, New Brunswick

<b>BOARD:</b>	Ms. Marie-Claude Doucet	Chair
	Ms. Francine Kanhai	Member
	Ms. Elizabeth Turgeon	Member

<b>Formal Intervenor(s):</b>	<b>Office of the Attorney General</b>	
	Mr. Michael Hynes	Solicitor
	Ms. Maya Hamou	Solicitor
	Ms. Paula Elliott	Consulting Actuary

**Decision Rendered:** May 10, 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 a written hearing on April 20, 2017 at the offices of the New Brunswick Insurance 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 commercial vehicles in New Brunswick.

[2] 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.

[3] In compliance with subsection 19.71(3) of the *Insurance Act, supra*, the Board provided to the Office of the Attorney General (“OAG” or “the Intervenor”), 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 submissions, and questioned the Applicant by way of written interrogatories.

[4] The Panel accepted the following exhibits from the Applicant and the OAG as part of the record as shown below:

EXHIBIT	DESCRIPTION	DATE
1	Original Rate Filing 2016-079	Apr 22, 2016
2	2016-06-08 Request for Missing Alternate Exhibits	Jun 08, 2016
3	2016-06-08 Alternate Exhibits	Jun 08, 2016
4	2016-06-20 Questions from KPMG	Jun 20, 2016
5	2016-07-07 Response to KPMG	Jul 07, 2016
6	2016-07-20 Follow up Questions	July 20, 2016
7	2016-07-29 Response to KPMG	Jul 29, 2016
8	2016-08-15 Follow up Question from KPMG MIR	Aug 15, 2016
9	2016-08-22 Response to KPMG	Aug 22, 2016
10	2016-08-29 Follow up Question from KPMG ROE	Aug 29, 2016
11	2016-08-29 Amendment	Aug 29, 2016

<b>12</b>	2016-09-12 KPMG Review Summary	Sep 12, 2016
<b>13</b>	2016-09-13 Questions from NBIB	Sep 13, 2016
<b>14</b>	2016-09-16 Response to NBIB	Sep 16, 2016
<b>15</b>	2016-09-16 Follow up Question NBIB	Sep 16, 2016
<b>16</b>	2016-09-21 Response to NBIB	Sep 21,2016
<b>17</b>	2016-10-31 Questions from NBIB	Oct 31, 2016
<b>18</b>	2016-11-03 Response to NBIB Oct 31 Questions	Nov 03, 2016
<b>19</b>	2017-01-27 OAG Questions to FA Round I	Jan 27, 2017
<b>20</b>	2017-02-08 FA Response to OAG Round I	Feb 08, 2017
<b>21</b>	2017-02-15 OAG Questions to FA Round II	Feb 15, 2017
<b>22</b>	2017-02-22 FA Response to OAG Round II	Feb 22, 2017
<b>23</b>	2016-03-08 FA Written Submission	Mar 08, 2016
<b>24</b>	2016-03-08 OAG Written Submission	Mar 08,2016

[5] The Panel, after examining the evidence and submissions made by the Applicant and the OAG, requested on April 21, 2017 that the FA provide revised overall indications for the impact of the following the combination of five (5) changes:

- 1) Modify the Accident Benefit (“AB”) Minor Injury Reform (“MIR”) Frequency conversion factor from +18.6% to 0%
- 2) Modify the AB past Severity trend rate from -6.5% to 0%
- 3) Modify the Accident Benefit MIR severity conversion factor from 22.6% to 0%
- 4) Correct the full credibility claim count standard for Third Party Liability – Bodily Injury (“BI”) from 2,164 to 3,264
- 5) Modify the pre-tax return on investment (“ROI”) from 0.51% to 1.5%

[6] The required changes as indicated above result in an average decrease to the overall rate indication of 3.5%, for an amended indication of 3.9%.

[7] The Applicant is ordered to incorporate changes to the rate application as noted in paragraph 5 above and is **approved to adopt the overall average rate change of +3.9%.**

[8] The approved rates will be effective on September 1, 2017 for new and renewal business.

## **1. Introduction**

[9] The Board is charged 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*, 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 on April 22, 2016 and an amended Filing was submitted to the Board on August 29, 2016.

[11]The Board issued a Notice of Hearing on December 5, 2016 and convened a Panel of the Board to conduct an oral hearing on the matter. The Office of the Attorney General provided notice of its intent to intervene in the rate hearing.

[12]Prior to the hearing, the Intervenor submitted two sets of questions to the Applicant, to which answers were provided. Written submissions were also provided by those parties to the Board.

## 2. Evidence and Positions of the Parties

### Facility Association

[13]The Applicant's Filing forms the main portion of its submission and the evidence before the Panel. The Board's consulting actuaries reviewed the Filing for material errors, and conducted an analysis of the methodology utilized by the Applicant along with the assumptions made, to ensure compliance with accepted actuarial principles.

[14]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”.

[15]The FA presented a Filing to the Board with an overall indication of +7.4% and proposed to select an average rate change in the same amount. Following are the changes proposed to the existing rates by coverage:

Bodily Injury	+18.9%
Property Damage – PD	+ 0.0%
Property Damage – Direct Compensation	-11.10%
Accident Benefits	+14.9%
Uninsured Automobile	- 0.4%
Collision	- 0.4%
Comprehensive	- 2.7%
All Perils	+ 18.9%
<u>Underinsured Motorist – SEF44</u>	<u>- 2.3%</u>
<b><i>Total</i></b>	<b><i>+ 7.4%</i></b>

[16]The revised rates contained in the Filing are produced assuming a target return on equity of 12%, a 0.51% return on investment and a 2:1 premium to surplus ratio. Proposed average rates would increase from the current average of approximately \$1,397.27 to approximately \$1,500.20.

[17]The Applicant submits that the Filing was prepared utilizing sound actuarial methods and practices, 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

[18]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 cross-examine the witness for the FA at the Hearing held on April 20, 2017, but same was declined by the Intervenor.

[19]In its final written submission (Exhibit 24) the OAG, through a report by consulting actuary Oliver Wyman (OW), challenged the Applicant's position on the following issues as summarized at page 24 and 25 of Exhibit 24:

It is our opinion that in determining whether the Commercial proposed by FA are just and reasonable, the Board should give consideration to the reasonableness of alternate assumptions and adjustments to FA's rate level indication calculations that we discuss in this report. Absent any additional information provided by FA:

1) We find that FA has not supported its assumption that the frequency trend rates for Bodily Injury changed from -5.7% to 0% following the July 2013 reforms. We find a frequency trend rate of -6.1%, for both the time period before and after the reforms, to be supported.

2) We find that FA has not supported its assumption that the frequency trend rates for Accident Benefits changed from -10.5% to 0% following the July 2013 reforms. We find a frequency trend rate of -9.3%, for both the time period before and after the reforms, to be supported.

3) We find that FA has not supported its assumption that the severity trend rate for Accident Benefits changed from -6.5% to 0% following the July 2013 reforms. We find a severity trend rate of 0.0%, for both the time period before and after the reforms, to be supported.

4) We find that FA's selected MIR frequency conversion factor of .913 (or -8.7%) for Bodily Injury and 1.186 (or +18.6%) for Accident Benefits to be based on insufficient data (only 3 accident half years with limited volume and credibility) and hence not supported. We find an MIR conversion factor of 1.00 or (0%) to be in compliance with the Board's guidelines.

5) We find FA's selected MIR severity conversion factor of 1.331 (or +33.1%) for Bodily Injury and 1.226 (or +22.6%) for Accident Benefits based on the Exactor Draft Report for Private Passenger Vehicles not to be in keeping with the Board's guidelines (and, in the case of Bodily Injury, not reflective of Exactors' Final Report). We find an MIR conversion factor of 1.00 (or 0%) to be in compliance with the Board's guidelines.

6) We find FA should correct its TPL full credibility claim count standard from 2,164 to 3,264 as originally intended by FA.

7) We find FA's pre-tax ROI of 0.51% to be low compared to the rates used by other insurers in New Brunswick.

8) We find FA's target pre-tax ROE of 16.4% (12% after-tax) to be high compared to that approved for FA by the Board in the past.

[20] The Intervenor goes on to argue at pages 25 and 26 of Exhibit 24 that changes to any of these assumptions would also affect the basis for the complement of credibility. The OAG further requested that the Applicant provide alternate rate level indications based on a variety of combinations of assumptions and these were presented in the written round of interrogatory questions. The impact of these alternate assumptions on the overall indication would be in the range of -3.6% to -4.9%.

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

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

[22]The Panel has reviewed all of the written evidence before it, along with the arguments of each parties, as well as the submissions of the parties, including actuarial reports prepared on behalf of each party and which were presented to the Board for the purpose of the hearing.

[23]Both parties provided evidence to the validity of their assumptions and actuarial methodologies and the Applicant answered a series of questions challenging its position, notably on the appropriateness of the actuarial approaches and methodology used.

[24]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 April 21, 2017.

[25]The Panel addresses each issues individually below:

***1) Selected Minor Injury Regulation Conversion Factor***

[26]In order to provide for the impact of the MIR on claim costs, the FA proposes to use different MIR conversion factors for severity and frequency and then combines these factors to achieve the MIR loss cost conversion factor.

[27]Due to the limited data that has emerged since the MIR reform, in terms of Severity, the Applicant proposed to use the conversion factor for BI of 1.331 (or +33.1%), and the AB conversion factor of 1.226 (or +22.6%). These constitute the Private Passenger Vehicle MIR conversion factors based on the *Summary Actuarial Report Re: Impact of the July 2013 Automobile Insurance Reforms on New Brunswick Private Passenger (Excluding Farmers)* by Exactor dated August 13, 2013 (herein after referred to as the “Draft Exactor Report”).

[28] In terms of Frequency, the Applicant proposed the use of conversion factors reviewing post July 1, 2013 (“Reform”) Commercial Vehicle Frequency data, and therefore applied

the conversion factors of 0.913 (or -8.7%) to measure the impact of BI, and 1.186 (or +18.6%) for AB.

[29] Combining the above noted conversion factors, the Applicant selected MIR Loss Cost conversion factors of 1.22 (or +22%) to measure the impact of BI and 1.45 (or +45%) for AB, the details of which are as follows:

	<u>Frequency</u> <sup>1</sup>	<u>Severity</u> <sup>2</sup>	<u>Combined Conversion Factor</u>
<b>BI</b>	-8.7%	+33.1%	+22%
<b>AB</b>	+18.6%	+22.6%	+45%

[30] The OAG takes the position that the data, being too limited to serve the purpose in determining the impact of the MIR, does not support the decrease in Frequency rates proposed by the Applicant. The OAG further raises as an inconsistency, the assumptions of the Applicant that the Frequency in BI will decline, while it will sustain an increase in AB and submits that an MIR frequency conversion factor selection of 1.00 (0%) would be more reasonable.

[31] In terms of Frequency, the Panel finds that the MIR conversion factor of -8.7% for Bodily Injury selected by FA is reasonable based on its support found in the past trend stemming from the data emerged over a ten year period.

[32] As for the Accident Benefits MIR frequency conversion factor of +18.6% selected by the Applicant, this Panel finds it to be unsupported by the data due to its limited quantity and lack of credibility and consequently agrees with the position of the OAG on this specific point that a selection of 0% would be more reasonable.

[33] In terms of Severity, the Applicant relied on the Draft Exactor Report's conversion factors, largely due to the volatility of the data that had emerged since the introduction of the MIR and the lack of sufficient data. On that particular point, the OAG took issue with the use of the Draft Exactor Report and argued that such practice went against the

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<sup>1</sup> Based on the Commercial Vehicle data.

<sup>2</sup> Based on the Draft Exactor Report.

Board's Guideline issued on September 2014 in the *Information Bulletin 2014-004*, which states the following:

2) Rate applications submitted for rates effective beginning in 2015 and beyond will be permitted to include conversion factors and trends for the impact of the amendments to the MIR applicable for those rates. ***The conversion factors and trends will have to be based on available data from New Brunswick experience only.*** These conversion factors and trends will have to be justified on a case-by-case basis by the insurer submitting the rate application.

[34] The OAG submits that, given the insufficient data available, the use of an MIR conversion factor of 1.00 (0%) for Severity would be more reasonable, as well as in compliance with the Board's Guidelines.

[35] It is true, as stated by the OAG, that section 2 requires conversion factors and trends to be based on available data from New Brunswick experience only. However, this section also indicates that the conversion factors must to be justified on a case by case basis.

[36] Despite the fact that the Guidelines are drafted with the intent that they be reasonably complied to, the Board as an administrative tribunal must be flexible when necessary in order to deal with all parties fairly and consider each case on its merits. Any alleged non-compliance is therefore not necessarily fatal to the Applicant's position in every circumstance.

[37] With respect to the MIR Severity conversion factor of +33.1% for Bodily Injury, despite the fact that this number is based on the Draft Exactor Report, the Panel finds the judgment decision made by the Applicant to be reasonable due to the limited data available and the model therefore not being fully credible. The Panel concludes that this is an appropriate case for the Board to exercise its discretion to accept the MIR Severity conversion factor as presented by the Applicant for the purposes of the analysis of whether the proposed rates are just and reasonable.

[38] That said, the Panel disagrees with the Applicant's selection of MIR Severity conversion factors for AB of +22.6% due to the volatility of the available data, creating a poor

statistical fit to its model. The Panel therefore determines that 0% is a more appropriate, just and reasonable factor to use.

## *2) Selected Trend Rates*

[39] The selection of Loss Trend rates requires the analysis of past data and the application of professional judgment in order to select trend rates that represent past experience and future expected results.

- *Bodily Injury*

[40] Both the Applicant and the OAG use different models to support their respective positions in terms of Frequency trend rates for BI following the July 1, 2013 reform (herein after referred to as “the reform”). The Applicant suggests the future trend will increase from -5.7% (the past trend calculated based on data that has emerged over a ten year period) to 0% based on FA’s selected regression model. The OAG argues that the Frequency trend for BI will rather continue to decrease at its past rate (-6.1% suggested).

The Panel determines that both approaches used by the Applicant and the OAG are acceptable. Both selected models showed strong statistical fit, and each approach depends on the application of professional actuarial judgment and practice.

It is the Panel’s view that FA’s model selection is actuarially sound. The Panel concludes that the evidence presented showed a good fit for recent period and that FA’s model selection is just and reasonable in the circumstances. The Panel therefore adopts the FA’s selection of -5.7% as the past trend and 0% as future trend for BI on Frequency

- *Accident Benefits*

[41] As for the trends for AB on Frequency, the Applicant finds support for its assumption on the commercial vehicle trend rate measured over the time period 2003-2 to 2014-2 to calculate the past trend rate of -10.5% changing to 0% for the future, beginning 2015-1.

FA submits that the adjusted R-square resulting from the regression analysis of 0.8143 supports the model selected.

[42] The OAG submits that the past AB Frequency trend based on commercial vehicle data for the time period 2003-2 to 2014-2, which results in a past trend of -9.3%, is more appropriate, and argues this trend will continue in the future.

[43] The Panel finds that the Applicant's trend projection supports the assumption of a future AB frequency trend of 0.00% and therefore favors the position of the Applicant on this issue.

[44] In terms of Severity trends for AB, the sole point of contention is the selection of the past trend. The Applicant calculates a past AB severity trend of -6.5% based on 2003-2 to 2013-1 commercial vehicle data that shows to be volatile. The FA argues a good statistical fit based on a p-value of 5%.

[45] The OAG takes the position that the regression model is not significant and that the volatility of the data available leads to difficulty in identifying a measureable trend. The OAG argues that, in such instance, zero would be a more appropriate selection.

[46] The Panel agrees that the Applicant failed to demonstrate that the past AB Severity trend of -6.5% is just and reasonable due to the volatility of the data. The Panel therefore accepts the argument presented by the OAG that the data better supports a Severity trend rate of 0.0% for both time periods, that is before and after reform.

### ***3) Profit Provision***

[47] For the calculation of its overall rate level change need, the FA includes a profit provision targeting a return on equity (ROE) of 12%, a premium to surplus ratio (PS) of 2 to 1, as well as a pre-tax return on investment (ROI) of 0.51% for cash-flow and surplus.

- ***Selection of target Return on Equity***

[48] The OAG objects to the use of a target ROE of 12% by the FA stating that in prior FA rate filing decisions, this Board had issued lower after tax ROE than the 12% selected by the Applicant. The intervenor also raises the Board's prior approval of FA's previous major filing, wherein the proposed rate change filed by the FA was based on a target after-tax ROE of 9%.

[49] Although not intended to be a benchmark that companies are expected to achieve, the Board has considered a target ROE of 12% to be reasonable for the purpose of developing overall rate indications. The Panel recommends that the Board in the future consider reviewing the issue of target ROE in light of changes to market conditions that have occurred over the past number of years.

[50] For the purpose of the present Application, the Panel of the Board finds that the selected target ROE of 12% is reasonable in the current market conditions.

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

[51] The process of developing rates which 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 are 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.

[52] The Applicant prepared its Filing by selecting a pre-tax ROI of 0.51% 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. This is based on marketable bond yields and Treasury bill yields published by the Bank of Canada, with the consideration of average investment duration based on claim payment pattern and estimated investment expense. The FA further submits 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.

[53] The OAG submits that the 0.51% ROI selection is very low in comparison to the assumed ROI of other insurers within their rate Filing and highlights that Financial Services Commission of Ontario (“FSCO”)’s profit guidelines require a minimum pre-tax investment rate of 2.25%. In its submission, the OAG further points to profit provision guidelines applied in the Province of Ontario pursuant to its administrative scheme. This Panel rejects those submissions. The Ontario regime is not before this Panel and to date, the Board has not issued any mandatory guideline on the issue of profit provisions.

[54] Nevertheless, the Panel agrees with the OAG’s argument that FA’s assumed ROI is significantly low and finds it is unreasonable based on the evidence presented. The Panel of the Board concludes that the rate of 1.5% would be more reasonable in light of the current investment market. Although not intended to be a benchmark, the Panel therefore orders the Applicant to modify its pre-tax investment rate to 1.5%.

#### *4) The Credibility Standard and Compliment of Credibility*

[55] The Applicant acknowledges that its Third Party Liability (TPL) full credibility standard of 2,164 was erroneously selected, and should rather have used 3,246. The Board therefore orders that FA correct its TPL full credibility claim count standard from 2,164 to 3,264.

[56] The Intervenor raises concerns with the compliment of credibility base used by the FA, notably, the OAG:

- a) Disagrees with the Applicant’s selected profit provision (ROE and ROI) used in calculating the permissible loss ratio underlying current rates.
- b) Disagrees with the MIR adjustments, also used to calculate the permissible loss ratio underlying current rates.
- c) Disagrees with the loss trend rates selected, which are reflected in the 1.25 year net trend adjustment applied.

[57] On the Complement of Credibility, the Panel accepts that the approach to credibility used by the Applicant is common and follows accepted actuarial principles. As such, the Panel accepts FA’s approach to credibility as reasonable.

## 4. Decision

[58] The Board has considered all of the evidence presented (listed as Exhibits), as well as the written submissions of the parties.

[59] For the reasons set out above, the Board finds that 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 AB Minor Injury Reform Frequency conversion factor from +18.6% to 0%
- 2) Modify the AB past Severity trend rate from -6.5% to 0%
- 3) Modify the AB MIR Severity conversion factor from 22.6% to 0%
- 4) Correct the full credibility claim count standard for Third Party Liability – from 2,164 to 3,264
- 5) Modify the pre-tax ROI from 0.51% to 1.5%

[60] The impact of these changes will be to lower overall rate indications from an average increase of 7.40% to an average increase of 3.90%.

[61] The Applicant is ordered to incorporate changes to the rate application as noted in paragraph 59 above and is **approved to adopt the average rate change of +3.90%**.

[62] The approved rates will be effective on September 1, 2017 for new business and renewal business.

Dated at Saint John, NB on May 10, 2017

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Marie-Claude Doucet, Panel Chair

WE CONCUR:

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Francine Kanhai

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Elizabeth Turgeon