

New Brunswick Insurance Board

DECISION

IN THE MATTER:

Of a rate revision application for the FACILITY ASSOCIATION
With respect to automobile insurance rates for
TAXI AND LIMOUSINE VEHICLES

Hearing Date: October 16, 17 and 18, 2018

Heard at Saint John, New Brunswick

PANEL:

Ms. Marie-Claude Doucet	Chair
Ms. Francine Kanhai	Member
Ms. Bernard Gautreau	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
Mr. Denis G. Thériault	Solicitor
Ms. Paula Elliott	Consulting Actuary

Consumer Advocate for Insurance

Ms. Michèle Pelletier	Consumer Advocate
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Decision Rendered:

November 23, 2018

Summary

- [1] Pursuant to subsection 267.5(1) of the *Insurance Act*, R.S.N.B., 1973 c. I-12 (the “Act”), the New Brunswick Insurance Board (the “Board”) convened a Panel of the Board to conduct an oral hearing (the “Hearing”) from October 16 to 18, 2018 at the Trade Convention Center 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 Taxi and Limousines Vehicles in New Brunswick. The FA is an unincorporated non-profit association to which every automobile insurer licensed in New Brunswick under the *Act* is a member. Under the *Act*, 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 *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 *Act*, the OAG intervened, called their own witness, 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, produced a witness and made written submissions and an oral submission during the Hearing.
- [3] During the hearing process the Panel accepted the following exhibits from the Applicant, the OAG and the CAI, as part of the record as shown below:

EXHIBIT	DESCRIPTION
1	FA Original Filing dated April 10, 2018

2	Question from NBIB dated April 30, 2018
3	Response to NBIB dated April 30, 2018
4	Round 1 Questions from KPMG dated May 9, 2018
5	Round 1 Response to KPMG dated May 15, 2018
6	Round 2 Questions from KPMG dated May 18, 2018
7	Round 2 Response to KPMG dated May 24, 2018
8	Round 3 Questions from KPMG dated May 28, 2018
9	Round 3 Response to KPMG dated May 28, 2018
10	Actuarial Summary KPMG dated May 28, 2018
11	Round 1 Questions from OAG dated August 3, 2018
12	Round 1 Response to OAG dated August 13, 2018
13	Response to OAG Request for Alternative Indications dated Aug. 16, 2018
14	Round 2 Questions from OAG dated August 21, 2018
15	Round 2 Responses to OAG dated August 24, 2018
16	CAI Submission dated August 24, 2018
17	OAG Submission dated September 4, 2018
18	FA Questions to OAG dated September 11, 2018
19	Responses to FA from OAG dated Sep 21, 2018
20	FA FINAL Submission Taxi dated Oct 5, 2018

[4] On October 23, 2018, following the Hearing, the Panel ordered the Applicant to provide revised overall indications for the impact of the following combination of changes:

- 1) For Third Party Liability (TPL) – Bodily Injury (BI):
 - a. Modify its past frequency trends to align the time segmentation (Scalar 2) with the adoption of the MIR reform;
 - b. In the case that the past frequency trends is negative, modify future frequency trends to half its value; and

- c. Maintain the past and future severity trends to +0% per annum.
- 2) Modify the proportion of Bodily Injury claims subject to Harmonized Sales Tax (HST) to 25% as opposed to the 67% originally filed.
 - 3) While maintaining the premium-to-surplus (P/S) ratio of 2:1, modify the return on investment (ROI) 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 (Ex ICBC-SAF, Ex Lloyd's), page 40.22 as at 2017.4 (YTD);
 - b. 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, 2017;
 - c. Bank of Canada selected treasury bill yields for 3 months as at December 30, 2017;
 - d. Corporate bonds nominal yield to maturity compounded semi-annually as at December 31, 2017 (as available in the CIA Report on Canadian Economic Statistics 1924-2017: Final Release – Tables or equivalent sources); and
 - e. Investment expenses at 0.15%.
 - 4) Modify the target ROE from 12% to 7%.

[5] The required changes as per above result in an overall indication of 8.4%, a decrease of 12.6% from FA's indication of 21.0%.

[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.

[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 + 8.4%**.

[8] The approved rates will be effective on September 1, 2019 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 *Act*. 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 at least once every 12 months from the date of its last filing. An insurer must appear before the Board when :

- a. The Insurer files for a rate change more than twice in a 12 month period, or
- b. The Insurer files rates where the average rate increase is more than 3% greater than the rates charged by it within the 12 months prior to the date on which it proposes to begin to charge the rates, or
- c. When the Board requires it to do so.

[10] A rate application requesting an average rate increase of over 3% was filed by FA for the taxi and limousine vehicles category, resulting in a mandatory hearing pursuant to the legislation.

[11] The Applicant's share of the New Brunswick taxi market on a premium basis was 98.4% in 2017, such that FA is currently the "market" for taxi insurance.

Procedural History

[12] The Applicant filed a rate revision application for the taxi and limousine vehicles category on April 13, 2018, seeking an average rate increase of 18.2%.

- [13] The Board issued a Notice of Hearing on June 19, 2018 and convened a Panel of the Board to conduct an oral hearing on the matter. The OAG and the CAI both provided notice of their respective intention to intervene in the rate hearing.
- [14] Prior to the Hearing, the Board's consulting actuaries, KPMG, submitted three rounds of questions to the Applicant, to which answers were provided. The OAG submitted two sets of interrogatories to the Applicant, to which answers were provided and FA submitted one set of interrogatories to the OAG. Furthermore, pre-hearing written submissions were provided by the Applicant, the AOG and the CAI to the Board.
- [15] The Panel allowed the examination and cross-examination of actuarial witnesses by the parties during an oral hearing held from October 16 to 18, 2018. Mr. Shawn Doherty, a Fellow of the Casualty Actuarial Society and Fellow of the Canadian Institute of Actuaries, testified as the expert witness for the FA. Mr. Rajesh Sahasrabuddhe and Ms. Paula Elliott appeared as expert witnesses for the OAG. Mr. Sahasrabuddhe is a Fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries. Ms. Elliott is a Fellow of the Casualty Actuarial Society and Fellow of the Canadian Institute of Actuaries
- [16] Furthermore, Mr. Gregory Clyde Easterbrook appeared as lay witness for the CAI.
- [17] The matters of FA's Rate Applications for Private Passenger Vehicles (PPV), Commercial Vehicles (CV) and Taxi and Limousines Vehicles were held consecutively. Given the commonality of many issues and evidence in these three rate applications, with the consent of the Parties involved in these matters, the Panel and the parties agreed that overlapping, common evidence would apply to all three hearings.
- [18] Finally, the Panel heard brief closing submissions from the Applicant, the OAG and the CAI following the witness testimony.

2. Evidence and Positions of the Parties

Facility Association

[19] The Applicant's Filing forms the main portion of its submission and the evidence before the Panel.

[20] The FA presented a Filing to the Board with an overall indication of +21.0% and proposed to select an average rate change of 21.0% based on its indication. Following are the changes proposed to the existing rates by coverage:

Bodily Injury (BI)	- 1.30%
Property Damage (PD)	- 1.30%
Property Damage – Direct Compensation (DCPD)	+ 98.20%
Accident Benefits (AB)	+ 34.70%
Collision	+ 12.40%
Comprehensive	- 10.40%
Specified Perils	+ 22.10%
Uninsured Auto (UA)	+ 14.00%
<u>Underinsured Motorist (UM) – SEF44</u>	<u>N/A</u>
Total	+21.00%

[21] The rates contained in the Filing are produced assuming a target return on equity (ROE) of 12%, a pre-tax return on investment (ROI) of 1.46% and a 2:1 P/S ratio. Proposed average rates would increase from the current average of approximately \$4,881 to approximately \$5,906.

[22] The Applicant submitted 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

[23] 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, and before the Hearing 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 questioning of its witness, actuary Ms. Elliott, and to cross-examine Mr. Shawn Doherty, the witness for the FA, and Mr. Easterbrook, witness for the CAI, at the Hearing held on October 16 to 18, 2017.

[24] The OAG's final written submission, in the form of a report by consulting actuary Oliver Wyman (OW), challenged the Applicant's position on the following issues [Exhibit 17, page 965 of the Record]:

It is our opinion that in determining whether the Taxi 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. We ask that the Board consider the following combination of alternative assumptions:

- Bodily injury frequency trend models recommended by Oliver Wyman.
- Accident Year Weights
- Recognition of Finance Fee Revenues
- Expense Provision
- A target pre-tax ROI of 2.55%.

[25] Finally, the OAG submitted to the Panel that should it find the alternative assumptions presented by its expert actuary more reasonable than those presented by the Applicant, and that the Applicant should be directed 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

[26] The CAI challenged the evidence related to the target return on equity provided by the Applicant and presented the Panel with a pre-hearing written submission and oral submission at the Hearing.

[27] The CAI also produced a witness, Mr. Gregory Clyde Easterbrook, taxi driver and Chairman of the City of Moncton Taxi Committee. At the hearing, Mr. Easterbrook testified to the fact that he currently owns and operates two taxis, and currently pays premiums of \$5,857, per vehicle, for liability coverage of \$2 million. Mr. Easterbrook testified that he cannot afford collision coverage, as this would result in an additional \$2,000 in premium. Mr. Esterbrook stated he had never been in an “at fault” accident and had never received a speeding ticket.

[28] Mr. Easterbrook stated that, in Moncton, taxi fare rates are set amongst all the taxis operating in Moncton, keeping in line with the rates charges in other Maritime Provinces major cities, including Saint John, Halifax and Charlottetown. This is distinct from the City of Saint John where taxi fares are regulated, and taxi drivers have to apply to the City Council in order to change their rates.

[29] In Mr. Easterbrook’s view, a rate increase such as the one requested by the Applicant would result in taxi drivers and operators dropping out of the market due to a decrease in profit margin. Notably, Mr. Easterbrook testified as follows on the impact of insurance rate increase and the nature of the services provided by the taxi industry in this Province (October 17, 2018 Transcript, pp. 302- 307):

The impact is eventually it is going to be priced out of the market and there will be people just dropping off because it has become unaffordable to drive a taxi with this kind of increases.

[...]

I checked with my broker and for the exact same vehicle, the exact same coverage for Nova Scotia would be 3,674 and for Prince Edward Island it would be \$2,904.[...]

I feel that in New Brunswick the taxis are being unfairly targeted as in New Brunswick a taxi [...]

[...] even though we have the strictest taxi bylaws in the Maritimes, we are still the highest rate for insurance and it is going to -- if it hasn't already, it is going to push owners out of the market. They will just stop driving taxi.

[...]

the services [provided by taxis in New Brunswick] are very wide. Yes, we do bring children to and from school or from school to daycare centers [...] We do take elderly people who no longer can drive to and from doctors' appointments, to and from groceries. We take social service clients and social development clients to and from appointments. We make deliveries of packages, anything from packages, and I myself have personally delivered the red and white cooler from the Moncton Hospital up to the Miramichi Hospital. So we deliver just about anything and everything.

3. Analysis and Reasons

[30] The Panel has reviewed all of the written evidence before it, the *viva voce* evidence presented at Hearing, and the oral submissions of the parties.

[31] In giving their evidence, the actuarial witnesses for both the Applicant and the OAG testified to the validity of their competing 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.

[32] At the hearing, the Panel recognized the actuarial expertise of the witnesses of the Applicant and the OAG for the purpose of the present Rate Application. The Panel considered the Applicant's challenges to the persuasiveness of Mr. Sahasrabuddhe's evidence and concluded that the concerns raised might affect the weight to be placed on the evidence, rather than admissibility. Where the experts disagree, the Panel has weighted the conflicting opinions in conjunction with the other evidence in the Record and the full matrix of considerations in arriving at a "just and reasonable" rate. The Panel's decision reflects that neither expert opinion was accepted *in toto*, and that each assumption and methodology decision is laced with layers

of data, assumptions and judgement. As set out below with more particularity, on some issues the Panel accepted the Applicant's evidence as satisfying its evidentiary burden of just and reasonable, while in other respects the Panel recognized the position of the Intervenors as persuasive and the Applicant failed to meet its burden.

[33] In its decision, the Panel also considers the testimony of Mr. Easterbrook appreciates this insight into the profound effect that insurance rates have upon members of society.

[34] 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 October 23, 2018.

[35] The Panel addresses each issue individually below:

1) Selected Loss Trend Rates

[36] 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.

[37] In its loss trend analysis, the Applicant used a regression model applied to industry CV experience over the past 20 years, as good proxy of taxi frequency and severity. The Applicant made its trend selection by selecting the same past and future trends for most coverages. However, the Applicant opted to apply different segmentations to the 20-year period with respect to the Frequency and Severity of some coverages, notably for BI.

- **Bodily Injury - Frequency**

[38] 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 CV ultimate claim counts over a 20-year period ending December 31, 2016 the Applicant’s selected model segments this period in three time periods: (1) 1997-H1¹ to 2003-H1; (2) 2003-H2² to 2011-H2; and (3) 2012-H1 to 2016-H2. The OAG agreed with the frequency rate selected for the period of 1997-H1 to 2003-H1. However, it disputed the segmentation of periods used by the Applicant for periods following the July 1, 2003 Minor Injury Regulation (MIR) Reform, as well as the past trend rates applied to period 2012-H1 to 2016-H2 and the selected future trend rate. Below are the frequency trend rates by period selected by the Applicant for its selected segments:

<u>Experience Period</u>	<u>Trend Rate Selected</u>
2003-H2 to 2011-H2	-3.50%
2012-H1 to 2016-H2	0.00%
Future	0.00%

[39] Based on its model, the FA selected a cut-off at 2011-H2 resulting in a BI frequency past trend rate of 0.00% for the periods subsequent to 2011-H2. FA provided the regression results such as an adjusted R-squared of 0.8706, p-values less than 5%, and onward to evidence the statistical validity of its selected BI frequency model (Exhibit 1, p. 246 of the Record). The FA’s selected BI frequency model cannot reject the 0.00% trend hypothesis. Taking into consideration the coherence within assumption set, the Applicant maintained the selected 0.00% BI frequency past trend level is appropriate.

[40] The OAG evidence countered the BI frequency past trend rate selected by FA for the 2012-H1 to 2016-H1 period. The OAG suggested it was not appropriate to apply segmentation to the post reform period (2003-H2 to 2016-H2), to include a parameter for seasonality, and exclude data points 2009-H1 and 2009-H2. The OAG provided the regression results to evidence the statistical validity of its frequency model, such as a high adjusted R-squared of 0.93, p-values

¹ H1 refers to first half year.

² H2 refers to second half year.

that support the significance of the explanatory variables, and residuals that are random (Exhibit 17, pp. 957-958 of the Record). While the OAG does not project snowfall, the OAG submitted that merit should be given to the consideration of the statistics from regression models with and without data point 2015-H1. The OAG proposed BI frequency model indicates a -6.1% past trend rate.

[41] The OAG argued in its final submission (Exhibit 17, pp. 957 of the Record), that the Applicant's model exhibits a poor fit for the time period subsequent to 2012-H1 and fails to consider underlying factors such as the 2003 MIR reform, seasonality and the influence of spikes in data points such as 2009-H1 and 2009-H2.

[42] The OAG argued that based on the model they proposed, the past frequency trend for BI shows that the pattern of decline persisted after 2011-H2, with the exception of the 2009-H1 and 2009-H2, which are argued to be visually extreme high data points, and 2015-H1, which the OAG attributes to the frequent snow storms and abnormally high snow fall in New Brunswick over this period.

[43] The Panel determines that both the FA's and the OAG's models are statistically sound and that both approaches are valid. The selection therefore depends on the application of professional actuarial judgment and practice. It is the Panel's view that a segmentation date of 2013-H1, which coincides with the MIR Reform, should be applied by the Applicant. Furthermore, the Panel finds that, as suggested by FA, no data points should be excluded. As a result, with these model specifications, FA estimated the past BI frequency trend at -5.7%.

[44] With respect to the BI frequency future trend, the OAG argued that the past trend of -6.1% will continue into the future, whereas the FA argued that its selected trend of 0.00% will also continue into the future. At the hearing, with respect to the considerations related to frequency modeling, Mr. Doherty testified to the following:

So level of claims frequency can change over time due to a variety of factors that directly affect the rates at which vehicles tend to be involved in collisions, are exposed to theft, et cetera. And these include economic conditions, weather conditions, road conditions, demographics, traffic density, driving behaviors and

attitudes, vehicular safety, et cetera. For example, during recessions there may be fewer vehicles on the road as fewer people are driving to work. And as people tighten their belts they may just choose to drive less.

Another example would be driving behavior changes related to drinking and driving which may become less sociably acceptable over time. And the sudden increase in distracted driving due to mobile phone use, texting and generally more bells and whistles within vehicles. Today's legalization of cannabis may also have an impact to the extent that incidents of driving high increases either suddenly or over time.

Driving behaviors can also change as vehicles become safer. Drivers may engage in more risky driving behaviors on the belief that their vehicles are safer.

[October 16, 2018 Transcript, pp. 26-27]

[45] Mrs. Elliott testified to the following:

[...] to try to explain why that experience happened the way it did, it is new to us that it needs to be backed up by science, as the Facility Association is submitting. I think we have heard multiple times actuaries come before the Board and say I consider these things. Sometimes they are talking about frequency, they say, well I wonder why frequency is going down. Well we do know that there is improved safety features on cars, lane assist and backup cameras and that sort of thing. No one ever comes in here and has been required by the Board to establish scientifically which cars - how many cars have them, what the effect of those safety features have. Sometimes we hear about severity being affected by things like airbags and the requirement to wear seatbelts and other safety features like that. In other words, sometimes actuaries just -- they know stuff and just like any other expert in any field, they just -- especially when they are experienced, they just know what kinds of things to think about. They don't have to come here and scientifically prove every consideration they make. Sometimes in the course of an actuary's work, they just know what kind of things to think about and it is certainly relevant to their analysis.

[October 18, 2018 Transcript, pp. 429-430]

[46] The Panel finds that the application of judgement by both the Applicant and the OAG are reasonable. However, in considering both assumption sets and the competing pressures, the Panel agrees with the OAG premise the future trend will continue to decrease, but the Panel is of the view that it is more reasonable to assume the decrease will be at a reduced rate. The

Panel therefore orders the Applicant to modify the future BI frequency trends to -2.9% or half the value of the proposed past TPL-BI frequency trend.

2) Accident Year Weights

[47] In the present Rate Filing, the Applicant provides historical accident year experience over a period of 10 years; 2007 to 2016. In the determination of its rate level change need, the Applicant chooses to assign weights of 20% to each of the last five years' (2012 to 2016) projected ultimate current rate level loss ratio. The rationale behind the approach adopted by FA is that each of the accident year projected loss ratios provides a reasonable representation of the expected loss ratio for the proposed ratings and the average of the loss ratios constitutes FA's selection.

[48] The OAG is generally in agreement with the above noted methodology used by the Applicant, but only in the instance where the volume of data for the coverage in question is not limited and/or demonstrates volatile loss ratios. The OAG disputes the application of equal weight to the latest five years of data for coverages that have a limited, and hence volatile, experience. Thus, in the present Application, the OAG disagrees with the methodology adopted by FA for the AB coverage, arguing the volatility of the data in the latest 5 years (with projected ultimate loss ratios ranging between 41.6% to 218.7%). Below is the table of projected ultimate loss ratios (ULR) for time period 2007 to 2016:

Accident year	ULR
2007	81.2
2008	36.8
2009	24.3
2010	20.8
2011	98.8
2012	153.0
2013	87.9
2014	218.7
2015	76.7

2016	41.6
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[49] On this issue, FA argued in its pre-hearing submission (Exhibit 20, p. 1002 of the Record) that credibility-weighting projected experience loss ratios with an appropriate complement projected loss ratio provide a “smoothing” function, and is therefore sufficient. Therefore, it is satisfied with its selected methodology of applying equal weight to the latest 5 years of data in projecting ultimate loss ratios.

[50] The Panel agrees that both methodologies used by FA and suggested by the OAG are reasonable for the determination of rate level change need. The Panel however disagrees with the argument of the OAG that the data for the AB coverage is too volatile in the most recent five years and that an average of the previous 10 years loss ratios is more reasonable. In those circumstances, the Panel accepts the methodology employed by FA to assign equal weight to the latest five years of experience.

3) Harmonized Sales Tax

[51] As the Harmonized Sales Tax (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 applied to approximately 67% of the total AB costs due to the Accident Benefits – Disability (AB-DI) sub-coverage not being subject to HST; the same assumption is selected to be applicable for BI. The Applicant recognizes that some heads of damages in BI claims are not subject to HST, thus they are not explicitly affected by the change in HST. However, FA argues that there will indirect impacts as the HST increase manifests itself in one-time increase in inflation that can influence the BI settlement amounts.

[52] The OAG disagreed 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%.

- [53] On this issue, the Panel rejects the argument of the FA on the application of an adjustment of +1.20% on the BI coverage. The Panel agrees with the position of the OAG, that only 25% of BI costs are subject to HST, as it is better supported. The Panel therefore orders FA to modify the proportion of BI claims subject to HST to 25% and apply an adjustment of +0.44% for HST for BI.

4) Finance Fee Revenues

- [54] Premium financing fees refer to a fee charged by servicing carriers to FA's policyholders when they choose to pay their premium on a monthly basis, as opposed to paying the full premium on an annual basis. The fees generally charged by FA's servicing carriers vary between 0% and 6%. The evidence shows that Co-operators General Insurance Company (Co-operators), the smaller service carrier, does not charge a premium finance fee to FA policyholders. Two of its largest service carriers, Royal & Sun Alliance Insurance Company of Canada (RSA) and Intact Insurance Company (Intact), charge a premium finance 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.
- [55] In this Application, FA did not include any consideration in its rate indication for the expenses or revenues related to financing fees. The rationale for this approach is that the financing activities do not form part of the Applicant's operations. FA affirmed that while a policyholder may have opted for a monthly premium plan, transaction records confirm that the full annual premium is recognized at inception of the insurance contract. This means that the service carriers retain the administration responsibilities and the credit risk of a monthly payment plan and the expenses and the revenues associated with the financing fees are not subject to sharing with the member-insurers.

[56] 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.

[57] In its Rate Application, FA argued:

If premium financing fee revenue were considered to be included as part of the determination of the overall indications for a particular insurer, the following would need to be addressed to ensure consistency in the revenue, return, and capital related to premium financing:

- i. supporting capital and the return on that capital needs to be included;
- ii. premium cash flow assumptions need to be altered to reflect "later" collection of cash (cash flows impact investment income – as later collection of premium reduces investment income, all else equal);
- iii. administrative costs associated with managing the premium financing function need to be included;
- iv. an estimate of the "bad debt" (i.e. credit loss) cost needs to be included (that is, an estimate of the long-term average credit loss – i.e. premium related to a policy period exposure that is ultimately not collected – so that coverage is provided during that period but no premium was paid).

[Exhibit 1, p. 62 of the Record]

[58] The issue raised by the OAG on this issue is that FA does not reduce its expense ratio in order to reflect the finance fees revenue, a decision that impacts rate indications.

[59] The OAG additionally submits that FA's largest servicing carriers (Intact and RSA) also offers 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 an inconsistent treatment of FA's policyholders in comparison to policyholders of other insurers that take into consideration the finance fee revenues in calculating their rate level needs.

[60] Extensive testimony and argument were provided to the Panel at the Hearing on the issue of premium financing fees and the Applicant has satisfied the Panel that it did not infringe the

current filing guidelines and that its approach was just and reasonable. That said, the Panel is cognizant that little direction is provided to insurers in this Province on the treatment of premium financing fees in rate applications. Though not applicable to the current Application, further to the Decision on FA's Rate Application for PPV dated December 15, 2017, the Panel takes notice that the Board has already initiated a process to investigate and consider this particular issue and provide additional clarity.

5) Profit Provision

[61] For the calculation of its overall rate level change need, FA includes a profit provision targeting a premium to surplus ("P/S") ratio of 2 to 1, a pre-tax return on investment (ROI) of 1.46% for surplus, and a return on equity (ROE) of 12%.

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

[62] The process of developing rates that are just and reasonable requires rate applications to account for the revenue received by the Applicant 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.

[63] The Applicant prepared its Filing by selecting a pre-tax return on investments (ROI) of 1.46% 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 argued that this rate matches the projected yield curve of the Government of Canada. In its submissions, the Applicant argued:

To the extent that members hold riskier investments and are able to generate higher return, those members would be required to hold more capital to reflect the risk embedded in the value of the asset. Our capital level is assumed to be consistent with a risk free portfolio of assets. [...] Any alternative assumption in relation to investment returns should be

considered in conjunction with appropriate change in supporting capital requirements.

[Exhibit 1, Record page 62]

[64] The OAG submitted that the 1.46% ROI selection is very low in comparison to the assumed ROI of other insurers and what was approved by the Board in the FA filing for PPV in December 2017. The OAG suggested the Board should direct the Applicant to take into account the more current investment rates that are available as of July 2018, as it is argued that these more closely reflect the rates that will be realized by the Applicant.

[65] The Panel agrees with the OAG's argument that FA's assumed ROI is unreasonably low and that the Applicant should assume a return on investment rate higher than the estimated return of a risk-free portfolio and use a 2:1 premium to surplus ratio.

[66] On the issue of the assumed ROI, as per our Request made to FA on October 23, 2018, the Panel directs the Applicant to modify its ROI, maintaining a 2:1 premium to surplus ratio, such that its relies on :

- a. The proportion of government bonds versus corporate bonds as reported in MSA Researcher, B04 – Total Canadian Property Casualty Industry (Ex ICBC-SAF, Ex Lloyd's), page 40.22 as at 2017.4 (YTD);
- b. 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, 2017;
- c. Bank of Canada selected treasury bill yields for 3 months as at December 30, 2017;
- d. Corporate bonds nominal yield to maturity compounded semi-annually as at December 31, 2017 (as available in the CIA Report on Canadian Economic Statistics 1924-2017: Final Release – Tables or equivalent sources); and
- e. Investment expenses at 0.15%.

[67] Based on the above, the Panel orders the Applicant to use an assumed ROI of 2.31%.

- **Selection of Return on Equity**

[68] In the development of its indicated rate change, FA uses a target ROE of 12%. The Panel however recognizes that FA insures the vast majority of the Taxi and Limousine vehicles insurance market, covering 99% of taxi and limousines in the Province of New Brunswick. During the hearing, the Panel heard from Mr. Easterbrook the plethora of services offered by taxis in the Province, including but not limited to : driving individuals to and from work, driving the elderly unable to operate a vehicle to and from medical appointments, transporting children to and from daycare centers and schools, driving social development clients who can't afford to own a vehicle to and from various appointments, and transporting samples from medical clinics to hospitals.

[69] The taxi industry in our Province undeniably provides valuable services to New Brunswickers. The Panel recognizes the importance of those services and accepts that it is in the general public interest for the Taxi industry to pay just and reasonable rates in order to maintain service availability.

[70] In line with the Panel's findings, for the purpose of the present rate application, the Panel finds that the Applicant use of a target ROE of 7% to be more reasonable than the selected 12% until FA's classification and segmentation analyses are refined. The Panel therefore orders the Applicant to use 7% as its target ROE for the development of its rate indication.

6) Expense Provision

[71] The expense provision included by the Applicant in the rates paid by policy holders is raised as an issue in this rate application. Pursuant to its Plan of Operation, FA pays a fee to its servicing carriers for the underwriting and processing of its policies. The said fee paid to the servicing carriers is based on a fixed percentage of 10% broken down as follows: 9% for servicing carrier operating costs and 1% for servicing carrier fee.

[72] The argument presented by the OAG on the above noted expense provision is that FA dismisses the actual costs of the servicing carriers for underwriting and processing policies and instead uses a pre-agreed percentage fee. Using such fee structure does result in the total expense provision per vehicle for taxi and limousine vehicles being over five times those of private passenger vehicles. On that basis, the OAG submitted that the actual costs of the servicing carriers should be used by FA in its rate application in order to ensure that the expense provision used to develop rates for taxi vehicles reflects the actual costs.

[73] In its submissions and during the hearing, the Applicant submitted that the expense provision fee structure, detailed in its Plan of Operation, was approved by the Superintendent of insurance. During the hearing, Mr. Doherty testified as follows:

The compensation arrangement with the servicing carriers is laid out in the Facility Association's plan of operation which has been approved by the Superintendent of Insurance in New Brunswick and which carries the force of law. Regardless of the expense provision that is included in the determination of the rates for insurance through the FARM, the servicing carriers will be paid by law what is stipulated in the plan. The servicing carrier provision we have included in our rate filing reflects the actual costs FA will incur per the plan of operation in relation to the servicing carriers at the proposed rates.

[October 16, 2018 Transcript, page 395]

[74] In light of the evidence presented to the Board, for the purpose of the present filing, the Panel recognizes that FA is required to pay fees to its servicing carriers as detailed in its Plan of operation. That said, the Panel was provided with no evidence indicating whether these fees accurately reflect the actual costs incurred by servicing carriers. The Panel does not find it has enough evidence before it to request a rate revision on this issue. However, the Panel finds that the OAG's concerns are valid and therefore makes a recommendation to the Board undertake a review of this issue with the Superintendent of Insurance.

4. Decision

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

- 1) For TPL-BI:
 - a. Modify its past frequency trends in order to align the segmentation (Scalar 2) with the adoption of the MIR reform;
 - b. In the case that the past frequency trends is negative, modify future frequency trends to half its value; and
 - c. Maintain the past and future severity trends to +0% per annum.
- 2) Modify the proportion of Bodily Injury claims subject to HST to 25% instead of the originally filed 67%.
- 3) While maintaining the premium-to-surplus ratio of 2:1, modify the ROI 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 (Ex ICBC-SAF, Ex Lloyd's), page 40.22 as at 2017.4 (YTD);
 - b. 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, 2017;
 - c. Bank of Canada selected treasury bill yields for 3 months as at December 30, 2017;
 - d. Corporate bonds nominal yield to maturity compounded semi-annually as at December 31, 2017 (as available in the CIA Report on Canadian Economic Statistics 1924-2017: Final Release – Tables or equivalent sources); and
 - e. Investment expenses at 0.15%.
- 4) Modify the target ROE 7%.

[76] The impact of these changes will be to decrease the overall rate indications from an average increase of +21.00% to an average increase of +8.4%.

[77] The Applicant is ordered to incorporate changes to the rate application as set out in paragraph 75 above and is **approved to adopt the average rate change of +8.4%**.

[78] The approved rates will be effective on September 1, 2019 for new business and renewal business.

Dated at Saint John, New Brunswick, on November 23, 2018.

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

WE CONCUR:

Francine Kanhai, Board Member

Bernard Gautreau, Board Member